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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 21
Financial Information Strategy:
Departmental Readiness

November 1999

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This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 21

Financial Information Strategy

Departmental Readiness

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Main Points

21.1 We found that most departments are just starting to focus on the Financial Information Strategy (FIS) despite the fact that the target implementation date for FIS, 1 April 2001, is less than two years away. At the time of our audit, while most departments had implemented new financial systems, they still had a lot of work to do to prepare these financial systems and to implement the accrual accounting policies to meet FIS requirements. Strategies for preparing managers to use the information provided by FIS to strengthen management decision making are not yet in place. We are also concerned that FIS is not seen as a high priority by senior managers.

21.2 In our view, the Treasury Board Secretariat, overall project manager for FIS, will need to assume a greater leadership role, drawing on some of the lessons learned in dealing with the Year 2000 problem. In particular, the central FIS Project Office will need to put in place and keep current an updated overall implementation plan, and use appropriate risk management capabilities, monitor implementation by departments and intervene constructively if problems arise. In addition, it will need to provide departments with required accounting policies and manuals, which are currently being developed, and assist departments in developing an appreciation of the use of FIS in day-to-day management.

21.3 Public Works and Government Services Canada (PWGSC) effectively carried out the development and implementation of new central systems. PWGSC and its major partners, the Secretariat and Revenue Canada, worked together to conclude a successful pre-production pilot of those new systems. We found that the Department and its partners established a detailed plan and risk management capability, monitored progress and intervened when necessary, and met key target dates.

Background and other observations

21.4 As we reported last year in our first report on FIS (September 1998 Chapter 18), the government is making sweeping changes in the type of financial information provided to decision makers. Under the Financial Information Strategy, new financial systems throughout government are being implemented. But FIS is much more than the renewal of aging financial systems. The Strategy is also designed to help the government strengthen significantly its management of business lines and its accountability to Parliament. To do this, FIS will generate full accrual accounting information similar to that used by the private sector and integrate this information into day-to-day decision making of departmental managers. The Office of the Auditor General continues to support fully these stated objectives of FIS.

21.5 The push for improvements in financial information to support government decision making started in 1962 with the Royal Commission on Government Organization (Glassco Commission). FIS was officially launched in 1989 and, after several false starts, the project was revitalized in 1995. A goal of April 2001 was published as the target date for implementation. We noted in our research that in some other jurisdictions, such as the Province of Alberta, the United Kingdom, Australia and New Zealand, financial management reform has progressed more rapidly.

21.6 Parliament's Standing Committee on Public Accounts held a hearing on Chapter 18 in October of 1998. The Committee called for the Treasury Board Secretariat to proceed with "all diligence and speed" in pursuing the option discussed in the chapter of changing the appropriations process to focus on resources consumed to achieve results rather than simply resources acquired. We saw this change in the appropriations process as a necessary step

in creating demand by departmental managers for full accrual information to strengthen day-to-day management and decision making. The Committee also called for the Secretariat to monitor the progress of FIS across all departments and agencies and to provide Parliament with better estimates of the total implementation costs. Estimates of FIS costs are still largely unknown or undetermined; only 11 of 24 departments that we surveyed had partial or full cost estimates.

21.7 One of the key aspects of successfully delivering a major initiative like FIS is the cultural change required at the management level to fully participate in and reap the benefits from the new approaches to informed decision making that FIS brings. The importance of change management has been well publicized in industry and in other government jurisdictions. Looking ahead, a major challenge for the Secretariat will be to provide guidance and lessons learned to departments with regard to this important issue.

The Treasury Board Secretariat's responses to our recommendations are included in the chapter. In line with the recent decision to increase its focus on implementation of the Strategy, the Secretariat will monitor departmental progress and take into consideration our recommendations.

Introduction

The Financial Information Strategy (FIS) is a needed reform

21.8 As we approach the new millennium, the Government of Canada is one of several governments around the world looking at new, modern ways of managing the business of government. The President of the Treasury Board indicated in his 1998 Annual Report to Parliament, Managing for Results, that government is “shifting from rules and processes to values and results with a focus on citizens, clients and taxpayers.”

21.9 The government is making the shift through ongoing program review and a move to results-based management. It is also exploring new ways of delivering the services Canadians expect of their government, including alternative service delivery, public/private partnerships and privatization.

21.10 The Standing Committee on Government Operations recognized the need for better information to support this new approach to governing. In its Third Report to Parliament in April 1997, the Committee said:

With the advent of government restructuring, alternative services delivery, new partnerships...there must be established as soon as possible a framework of accountability to assure the various stakeholders, public and private, of greater access to information on performance and results of public programs and services. This is the essence of improved public transparency.

21.11 The government introduced its modernization of comptrollership initiative in response to this call for a modern management agenda. The Deputy Comptroller General of Canada describes modern comptrollership as “an integrating concept — one that brings information

from many sources into a meaningful whole and that communicates that information to those who need it. Modern comptrollership supports an open, accessible, values-driven and results-oriented government.”

21.12 With a vision to “enhance the government’s decision making and to improve organizational performance through the strategic use of financial information,” the Financial Information Strategy (FIS) is critical to modern comptrollership and provides tools that support this new way of managing. The target date for FIS implementation is 2001.

21.13 A key objective of FIS is to provide departmental management, at all levels, with more relevant, reliable and timely financial information. This information would then be used in conjunction with other performance and operational information to help make key program and other decisions. The first edition of the FIS newsletter in November 1997 stated that FIS supports “the first three of the four key elements of comptrollership...” These elements are performance information, risk management and control systems. The fourth key element is ethics and values, which has “long been associated with the financial community.”

21.14 To achieve this vision, the government is implementing modern financial systems throughout government and is moving to an accrual accounting environment similar to that used by private sector businesses.

21.15 To be successful, organizations need to begin with a clear articulation of business needs and then design strategies, systems and tools that meet these needs. The Year 2000 problem had an impact on the implementation of new financial systems, as most government departments and agencies implemented their new financial systems as a Year 2000 solution and therefore earlier than might have been planned for FIS. As a result, the systems

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A key objective of FIS is to provide departmental management, at all levels, with more relevant, reliable and timely financial information.

The Office of the Auditor General continues to support the objectives of FIS and is keen to see the Strategy fully implemented as soon as possible.

The Strategy supports the government's drive to change how the business of government will be managed.

were put in place under the old accounting and management environment and will likely require reconfiguration to meet the government's modern management requirements under FIS. These new financial systems are a key component of "enterprise-wide resource planning" systems that have the potential to touch all areas of management and affect, to varying degrees, every business process. Reconfiguration for newly articulated business needs is possible but requires considerable thought and care in execution.

21.16 New financial systems and businesslike accounting policies are important to the government as it attempts to introduce modern financial management practices. However, it is necessary to remember that these are simply a means to an end — managerial use of better information for decision making — not an end in themselves.

21.17 The Office of the Auditor General continues to support the objectives of FIS and is keen to see the Strategy fully implemented as soon as possible. As we stated in our chapter on FIS in 1998, there have been calls for financial management reform for over 35 years, starting with the Royal Commission on Government Organization (Glassco Commission) in 1962. The 1979 Royal Commission on Financial Management and Accountability (Lambert Commission), the 1997 Independent Review Panel on the Modernization of Comptrollership in the Government of Canada and several Auditor General reports have echoed the call for reform.

Departments and agencies are key to the success of FIS

21.18 In the past, all financial transactions were processed centrally by Public Works and Government Services Canada and maintained in the central accounting system. The government's annual financial statements were prepared

from this centralized information. For management information purposes, many departments and agencies maintained duplicate information in their own management information systems.

21.19 Under FIS, financial management and accounting will be decentralized. Departments will now be responsible for processing and maintaining detailed financial transactions in their own financial systems. Departments will submit to the new central systems only the summary information required for government-wide reporting and analysis. In addition, departments will now be required to produce accrual-based departmental financial statements that can withstand the test of audit.

21.20 Departments are to be more businesslike in their decision making. As envisaged, FIS will help departments achieve this by laying a foundation involving the use of financial tools similar to those used in the private sector, such as costing and businesslike accrual accounting practices. In combination with non-financial performance and operational information, FIS should provide departmental management with the timely, relevant and reliable information needed for day-to-day decision making in the years ahead.

21.21 FIS changes significantly how financial information will be captured and maintained by departments. However, it is not simply a centrally driven initiative to change the government's summary level financial statements — this is a secondary objective of FIS. The Strategy supports the government's drive to change how the business of government will be managed. It is therefore designed primarily for the benefit of departments in meeting their responsibilities in the new management environment.

21.22 To ensure success, departmental managers, both program and financial, need to understand and buy into the full vision of FIS, including improved financial management and full reporting

of results. In our view, if managers do not take an active interest in the quality of their departments' financial information, there is an increased risk that data quality and integrity could suffer.

21.23 In addition, departments will need to ensure that they have the required financial expertise to properly exercise their increased responsibility under FIS. As a result, managing the changes in training as well as in people's roles and responsibilities will be a key component of successful implementation of the full vision of FIS. Experience elsewhere has shown that new staff, familiar with modern accounting and comptrollership concepts and techniques, will need to be recruited. Some departments have already started this process. Secretariat officials indicated that they are pleased with the results of the Financial Officer Recruitment and Development (FORD) program in recent years. The Treasury Board Secretariat is also holding discussions this fall on creating an initiative to recruit middle-level financial officers.

Financial management reform is occurring in other jurisdictions

21.24 Canada is not alone in attempting to change how it manages the business of government. Many other jurisdictions, both within Canada and internationally, have also introduced or are planning to implement modern financial management and, in some cases, even broader reforms. These include New Zealand, Australia, the United Kingdom and the Province of Alberta (see Exhibit 21.1).

21.25 A common thread in these jurisdictions was the desire to move to a more businesslike management framework — one that focusses on results, rather than inputs. In all cases, these reforms saw the adoption of accrual accounting practices as a logical component of the new management culture and not an end in itself. In

addition, there was strong political support, at the highest levels, which helped drive the change in management philosophy.

21.26 The Auditor General of Canada and the Chair of the Federal Standing Committee on Public Accounts (PAC) attended the Australasian Council of Public Accounts Committees in Australia in February 1999. They were briefed by Australian and New Zealand government officials on developments in public sector management, accounting and reporting in those countries. On their return, they submitted a joint report to the Canadian PAC's sub-committee on International Financial Reporting Guidelines and Standards for the Public Sector. This report, available from the Canadian Public Accounts Committee, has information on the Australian and New Zealand experience.

There are a number of drivers for FIS

21.27 The Minister of Finance's 1995 commitment to move to an accrual accounting basis provided a much-needed push to the stalled FIS initiative. Unlike other jurisdictions though, this commitment was not accompanied by a widely shared and clearly articulated vision of an operating philosophy or culture of which FIS would be seen as a logical part. According to Treasury Board Secretariat officials, however, the recent initiative to modernize comptrollership in the Government of Canada represents that broader vision.

21.28 FIS is often talked about in the context of the longer-term comptrollership initiative, particularly in the area of management decision making. In fact, the Secretariat has referred to comptrollership when responding to a number of issues that the Office has raised in previous audits (see Exhibit 21.2). While we recognize that comptrollership provides an overall financial management framework within which FIS will eventually operate, comptrollership is still in its early stages

Departments will need to ensure that they have the required financial expertise to properly exercise their increased responsibility under FIS.

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Exhibit 21.1

**Financial Management Reform
in Other Jurisdictions**

New Zealand

As a result of a financial crisis, the Government of New Zealand introduced a series of reforms designed to place the government on a more businesslike footing. The government introduced the notion of a minister purchasing services from the public service. This is formalized in a series of purchase agreements between the Minister and the Secretary (Deputy Minister) or Chief Executive. These agreements require clear expectations for the nature and price of the goods and services to be delivered by departments. Parliament, through the appropriations process, votes the resources to ministers to purchase the required outputs (goods and services).

Departmental managers were given the freedom to manage their organization within the terms of the purchase agreement. A great deal of operational autonomy was given to heads of departments and agencies. In addition, the personal performance of these senior managers is assessed against individual performance agreements. Therefore, an essential part of the accountability framework is the reporting of the financial results and accomplishments against the performance targets. There is a comprehensive quarterly reporting against departmental purchase agreements and personal performance agreements.

Australia

The Commonwealth of Australia government recognized that a cash and input-based resource management system was inadequate. Such a system did not promote best practice management or accountability. The government believes that a modern, accrual-based management framework facilitates solid analysis and good decision making about resource usage and financial position.

The government tabled its first outcomes- and outputs-based budget in May 1999. This accrual-based approach represented a major shift in the way the Australian federal government budgeted and managed its resources. Under the new framework, outcomes (results) and outputs (deliverables) become the focus of how agencies plan, budget and report. Outcomes are the results government expects to achieve while outputs are the goods and services agencies produce to contribute to the achievement of the outcomes. Agencies are resourced for the price of their outputs. This price includes full costs, such as depreciation. Accrual accounting provides agencies with the financial information required for the pricing of outputs.

United Kingdom

In March 1999, the United Kingdom issued a white paper on modernizing government, a central piece of the government's renewal and reform program. In the section, Quality Public Services, the paper describes a number of levers to drive up standards in public services. These include the Comprehensive Spending Review which established a new approach to improving service delivery. The new Public Service Agreements (PSAs) set out in detail what people can expect in return for new investment. Ministers and their departments will be held to delivery of the priorities set out in the PSAs. These priorities are cascaded through targets and measures that will be set for all public bodies, in consultation with those that receive services. The government has also developed a new approach to public expenditure planning and control. Three-year spending plans have replaced annual plans for departments wherever possible. The scope of year-end carry forward provision has been increased to reduce the year-end spending rush. The introduction of resource accounting and budgeting, during the 1999–2000 budget year, will replace the archaic use of cash-based accounting. This will mean better linkages between the resources put in and what is achieved, and will increase the incentives for assets to be managed effectively.

Province of Alberta

The Government of Alberta introduced accrual accounting and performance reporting as part of its broader financial management reform. As part of the Premier's agenda of bringing a more businesslike approach to governing the province, ministries are now required to prepare fully consolidated business plans and present business cases for new initiatives. New financial systems, performance reporting and a move to accrual accounting supported this change in management philosophy. In response to these new requirements, managers began to demand better financial information.

and, according to the Treasury Board Secretariat Comptrollership Modernization Office, it has a 7 to 10-year implementation time frame. There is a risk of delay in achieving the full benefits of FIS if key aspects begin to be associated with this longer-term project.

21.29 The high-priority requirement to deal with the Year 2000 problem pushed departments to implement new financial systems while they, and the government as a whole, were determining the FIS framework. In a sense, the Year 2000 problem has been both a blessing and a curse. On the one hand, it has moved forward the implementation of replacement financial systems, while on the other hand, it has forced early implementation of certain aspects of FIS in most departments without determining

the management needs that FIS will need to serve.

21.30 The Treasury Board Secretariat expects to produce the first accrual-based government-wide financial statements for the 2001–02 fiscal year. Secretariat officials informed us that these financial statements will be seen as a critical indicator of FIS success in the shorter term. They also indicated that they will take the appropriate measures necessary if some departments are unable to provide accrual-based information at that time. Currently, this goal is driving the implementation of new accrual-based accounting systems and of accrual accounting policies.

21.31 Although it makes sense to break a large project into manageable components, there is a risk that

FIS is more than simply producing accrual-based financial statements.

Exhibit 21.2

Summary of the Treasury Board Secretariat's Responses



Chapter 18 September 1998

The Financial Information Strategy: A Key Ingredient in Getting Government Right



Chapter 2 April 1997

Financial Management: Developing a Financial Management Capability Model



Chapter 3 April 1997

Management of the Government's Accounting Function: A Central Agency Perspective



Chapter 5 April 1997

Reporting Performance in the Expenditure Management System



Chapter 11 October 1997

Moving Toward Managing for Results

In all cases, the Treasury Board Secretariat's response included reference to the comptrollership initiative, which has a longer-term implementation time frame.

FIS is about providing those who manage our tax dollars with financial information to permit them to make better program decisions.

The Year 2000 problem prevented FIS from being implemented in what would generally be considered a logical order.

departments might focus solely on shorter-term goals and take the emphasis away from the full objectives of FIS. FIS is more than simply producing accrual-based financial statements. It is mainly about providing those who manage our tax dollars with more relevant, reliable and timely financial information to permit them to make better program decisions.

21.32 Circumstances, such as dealing with Year 2000, have resulted in a step-by-step implementation approach for FIS that has put systems first. While this may represent a practical reality, the government needs to ensure that it does not declare victory on FIS until all steps have been completed — that is, until the appropriate accounting policies are in place and the information that FIS provides becomes an integral part of day-to-day decision making.

The Public Accounts Committee considered FIS in 1998

21.33 The Public Accounts Committee held a hearing on the 1998 chapter on FIS. Its report to Parliament provided full support to the issues raised in the chapter and made four recommendations to the government. The Committee's report is included in Appendix C of this Report. The Committee asked the Treasury Board Secretariat to prepare options for a move to accrual appropriations, to consult with stakeholders and to prepare a plan to implement the chosen solution. It also asked that the Secretariat monitor departmental implementation, inform Parliament of any impediments to successful implementation and provide it with an estimate of the total cost of implementation. The Secretariat agreed with these recommendations and its action on them is discussed in paragraphs 21.109 to 21.111.

Focus of the audit

21.34 This is the second of a series of audits on the implementation of the Financial Information Strategy. In our first

chapter, published in September 1998, we focussed on broader central issues surrounding FIS such as accrual appropriations, the development of the FIS accounting and control framework, the Treasury Board Secretariat's management of FIS overall and the development of the new central systems. This year the audit focussed primarily on the readiness of departments to implement FIS. We also continued our review of the broader central issues.

21.35 The objectives of the audit were to:

- assess the state of FIS readiness in a selection of departments;
- review the management of FIS overall by the Treasury Board Secretariat;
- examine the implementation of the new central systems; and
- follow up other significant issues raised in our September 1998 chapter as well as the recommendations made in Chapter 3 of the April 1997 Auditor General's Report.

21.36 Further details on the audit are found at the end of the chapter in **About the Audit**.

Observations and Recommendations

Departmental Readiness to Implement FIS

The Year 2000 problem has been a major distraction

21.37 As mentioned earlier, the appearance of the Year 2000 problem, the scale of which required resources and urgent action, prevented FIS from being implemented in what would generally be considered a logical order — that is, to determine first the overall management framework or culture, then the accounting information structure and finally the systems required to support these.

21.38 The Year 2000 issue has pushed most departments to implement new financial systems early and therefore these systems generally continue to process transactions in the old way and still connect with the old central accounting system. As a result, there has been limited business re-engineering with implementation of these interim systems. Modern enterprise-wide systems usually require that re-engineering be done first.

Serious departmental planning for FIS is just starting

21.39 To implement FIS we would expect dedicated implementation teams to consist of people with systems, financial and change management skills as well as representatives from program management. Only 5 of the 24 departments we surveyed had these integrated teams in place.

21.40 Most departments indicated in the survey that they expect to have FIS plans in place in late 1999 or early 2000. Early indications are that these plans will focus primarily on the development and implementation of interfaces with new central accounting systems along with the analysis and implementation of the new accrual accounting policies. Only two of the surveyed departments have assessed risks associated with implementing FIS.

21.41 Change management is important because it deals with how to motivate managers to use accrual-based financial information for day-to-day decision making. However, where this has been considered as part of the planning process, the focus has been on the necessary training for new systems and accrual accounting. Only 1 of the 24 departments we surveyed had a plan that considered the changes required to bring about the new management culture.

Less than two years to the target date

21.42 There are less than two years remaining before the publicly declared April 2001 target for FIS implementation. Treasury Board Secretariat officials have informed us that by this date they expect to have all departmental financial systems connected to the new central systems and to have the necessary accrual accounting policies in place to permit the preparation of accrual-based summary-level financial statements for the government as a whole for the 2001–02 fiscal year. However, to meet the need for the significant change in management culture required by FIS, as well as for comptrollership, the Secretariat recently indicated to us that they will prepare managers as much as possible leading up to April 2001, use 2001–02 as a building year and do continuous improvement after that.

21.43 Treasury Board Secretariat officials indicated to us that they have six pilot departments leading the way on comptrollership. Discussions are under way within the Secretariat for future implementation of comptrollership to include a cultural change component. In his presentation to the European Commission in April 1999, the Secretary of the Treasury Board and Comptroller General said that the Secretariat is looking for substantial modernization in the pilot departments with visible results by the fall of 2001, the same time that the Secretariat expects to have its comptrollership responsibilities in place. However, he also said that it will take 7 to 10 years for all parts of government to move to modern comptrollership.

21.44 The full implementation of FIS in departments and agencies — new financial systems, new accounting rules and the use of better financial information to manage — is the responsibility of the deputy minister or head of agency. In this regard, we believe that they need to make the full implementation of FIS a departmental priority. We reviewed departmental Reports on Plans and

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**It is important that
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Priorities for 1999–2000 and found little mention of the Financial Information Strategy. Since FIS is a key tool for providing financial information for program management, it would be reasonable to expect that departments would make a public commitment to FIS in their departmental Reports on Plans and Priorities documents to be tabled in Parliament in the spring of 2000.

21.45 Planning is crucial. FIS implementation requires a well-defined and understood “destination” — that is, how the future financial management environment will look, a change management strategy to reorient managers to a more modern way of managing, as well as the financial systems and accounting policies that are needed to support this future environment. Only one department in our survey had planned its FIS implementation in this manner.

21.46 It is important that FIS planning in departments start now to ensure success. As described above, implementation is more than simply

connecting to new central accounting systems. All of this takes time. Setting up a project team and infrastructure in a department can take several months. The scoping, business case preparation and planning exercise can take another few months. The development and implementation of accounting policies can take a year to put in place.

21.47 As shown in Exhibit 21.3, Public Works and Government Services Canada (PWGSC) expects, based on the results of the pre-production pilot, that building interfaces to connect the new departmental financial systems to the new central systems, if tightly controlled, would take a minimum of nine months once a dedicated project team is appointed and working. The testing of departmental interfaces to the new central systems needs to be co-ordinated with PWGSC while taking into account the logistics and scheduling of other departments that need to test their connections at the same time. PWGSC indicated that in cases where a department could use an existing interface without modification, then the amount of time may be reduced.

21.48 Finally, changing the financial management culture of a department can easily take up to two years, and even longer if major organizational changes are required or if new staff needs to be recruited as a result of a departmental analysis of competencies required in the future versus those in place now. Nine of twenty-four departments we surveyed were unable to provide us with summary data on financial staff qualifications.

21.49 The work described in the preceding few paragraphs will be a daunting task for departments that plan to move to FIS in 2001. The implementation of FIS-compliant financial systems and accrual accounting policies may be feasible if the momentum created by Year 2000 is maintained. However, it is important that departments not lose sight of the fact that FIS is more than systems and policies. We are concerned that

Exhibit 21.3

Connecting to Central Systems: Key Milestones

The key milestones, and related requirements, for the connection of departmental financial systems to the central systems are:

30 June

- Memorandum of Understanding with the cluster group
- Steering committee
- Project team
- Specifications
- Implementation plan
- Work started on coding

1 September

- Testing under way

November to December

- End-to-end testing started and completed

31 January

- Test result sign off and decision on 1 April implementation

Source: Public Works and Government Services Canada

departments may become complacent and not place the appropriate focus on their business needs and changes in management culture needed to reap the full benefits of FIS.

21.50 The Secretariat has asked 23 departments to connect to the new central systems in April 2000. The selection of departments was still being finalized at the beginning of August 1999. Government officials advise that they understood the risks of going ahead even though the 30 June milestones were not met (see Exhibit 21.3). The officials further advised that implementation by at least some of the 23 departments would reduce the load in 2001, thus reducing the overall risk.

21.51 We are concerned that these departments now have less than the expected minimum time required to implement their system interfaces. This pressure on the schedule creates a very high risk that, if these compressed deadlines are not met, there will be a domino impact on the 2001 implementation schedule. The key implementation milestones for connecting to the new central systems in 2001 commence in June 2000. To maintain the necessary momentum and to ensure success, strong project and risk management will need to be continued during this process.

FIS is incorrectly seen as just an accounting exercise

21.52 We found that all of the departmental implementations of FIS are being driven by the finance and/or corporate services areas that will be responsible for providing central agencies with the accrual-based summary information required to produce the government-wide financial statements in 2001–02. To date, senior management sponsorship and program manager support are generally missing. To dispel this image of FIS as simply an accounting

exercise, we would expect to see senior sponsorship or involvement from the program areas (business side) of departments. The results of our survey indicate that 4 of 24 departments have a sponsoring group extending beyond the finance and corporate services areas. Five other departments have communicated with senior and program managers, but do not yet have their active involvement.

21.53 As a result, in most departments the current focus is on connecting the new financial systems to the FIS central systems and implementing accrual accounting policies by April 2001 to meet external reporting requirements. In all 24 of the departments we surveyed, the new financial systems have largely replaced the functionality of the “legacy” financial systems and processes. Consequently, at this time they provide limited program management information.

21.54 The financial officers in several of the departments we audited are finding it difficult to engage line managers and senior executives because it is hard to convince them of the benefits of FIS. Compelling drivers have not yet been provided to these officers to help them encourage managers and executives to change their traditional management practices.

21.55 The message that needs to be delivered to program managers is that, under the full vision of FIS, they would have more relevant, reliable and timely accrual-based financial information that can be used for:

- period-over-period comparisons and trend analysis;
- program costing information for:
 - user fees and cost recovery decisions
 - business planning
 - performance reporting
 - alternative service delivery analysis

The Secretariat asked 23 departments to connect to the new central systems in April 2000. These departments now have less than the expected minimum implementation time required.

Compelling drivers have not yet been provided to financial officers to help them encourage managers and executives to change their traditional management practices.

- public/private partnership analysis;
- capital asset management including maintenance and rust-out prevention;
- make-versus-buy analysis;
- lease-versus-buy analysis; and
- inventory management.

To date, even with new financial systems, management information continues to be poor.

21.56 However, to date, even with new financial systems, management information continues to be poor. Several departments indicated that their new “state of the art” systems have not yet been able to provide managers with meaningful reports. While financial information is generally available on a responsibility centre basis, program cost information is not usually available. For example, departments continue to be unable to provide reliable actual cost information on departmental projects such as FIS or Year 2000. Of the 24 departments we surveyed, 11 provided us with partial cost estimates for FIS. However, Secretariat officials informed us that departments have not been required to separate FIS costs, nor has there been a methodology given to departments to calculate them. The Secretariat says that a special costing project would be required to assemble and analyze FIS-related costs. We believe that capturing reliable cost information on an ongoing basis is necessary for effective decision making and should be integral to implementing FIS.

21.57 Departments and their deputy ministers should make FIS implementation a priority and make a public commitment to that effect in their departmental Report on Plans and Priorities documents in the spring of 2000.

Treasury Board Secretariat's response:
The content of a department's Report on Plans and Priorities is the prerogative of the deputy head. These documents are primarily intended to display commitments

to Canadians, but the Secretariat also encourages the inclusion of significant commitments to management improvement initiatives.

21.58 Departments should designate a senior-level sponsor of the FIS initiative, someone who is in a position to promote FIS beyond the finance area.

21.59 Departments should immediately establish dedicated FIS implementation teams that integrate systems, accounting and change management skills as well as program management representatives.

21.60 Departments should implement a FIS awareness communications campaign for line and senior managers, highlighting how FIS will help them manage in the future government environment.

21.61 Departments should immediately develop plans that cover all aspects of FIS implementation. These plans should include:

- a description of the department's future financial management environment; and
- a comprehensive timetable and plan/strategy to:
 - connect the departmental financial system to the FIS central systems;
 - determine and implement appropriate accrual accounting policies and procedures needed to produce auditable departmental financial statements; and
 - move the department to the future financial management environment. This should include:
 - a gap analysis of the current versus future decision making environment and business processes;

- a communications plan to increase FIS awareness and to establish two-way consultation;
- a training analysis and plan; and
- an analysis of the human resource competency and capability.

Treasury Board Secretariat's response:
The recommendations to departments in 21.58 to 21.61 are consistent with guidance issued by the Treasury Board Secretariat in January 1999, entitled Financial Information Strategy in the Canadian Federal Government: Implementation Strategy Guide. The Secretariat will monitor progress in departments.

Treasury Board Secretariat Leadership, Management and Monitoring

The Secretariat's handling of the Year 2000 problem sets a leadership precedent

21.62 Government-wide initiatives require strong leadership, particularly as deadlines approach. One such case has been the government's efforts to deal with the Year 2000 problem. The Treasury Board Secretariat took on a greater leadership role with the support of the Office of the Auditor General and the Public Accounts Committee.

21.63 In its November 1997 report on the Auditor General's Year 2000 audit work, the Public Accounts Committee recognized:

Accountability is an issue that is of greatest importance to this Committee. In terms of taking effective action and achieving satisfactory results, there is great merit in having one department, and

one individual within that department, capable of taking the lead responsibility for solving problems. Knowing who holds the responsibility means knowing who is in a position to make decisions and to act on them. It means knowing who is in charge.

21.64 During the hearings, the Committee was told that departments were responsible for ensuring that their systems were adequately prepared for Year 2000. The Treasury Board Secretariat, for its part, was responsible for providing guidance and leadership on this challenge throughout government, particularly in the search for solutions to common problems.

21.65 The Public Accounts Committee believed that this might have been an appropriate division of responsibility under normal circumstances, but that in this instance more assertive action by the Treasury Board Secretariat would be necessary. The Committee recognized that this would require the Secretariat to go beyond its usual role as a leader and a facilitator and intervene strategically where needed.

21.66 In response to the Committee's recommendations, the Treasury Board Secretariat and departments and agencies increased the priority on finding solutions to the Year 2000 problem. The Secretariat identified government-wide mission-critical systems and instituted a monthly process to report progress. Additional funding was also made available to departments to allow them to obtain the necessary Year 2000 resources.

21.67 These assertive actions by the Secretariat helped to increase the pace of departmental action in dealing with the Year 2000 problem. We raise this precedent because we believe that the Secretariat could apply some of these lessons learned in dealing with FIS in the critical months and years ahead.

Government-wide initiatives require strong leadership, particularly as deadlines approach.

Departmental implementation was planned to take place in an orderly fashion over the final three years, starting in April 1999.

Full implementation of FIS was expected to be completed by 2001–02.

While deputy ministers are responsible for the implementation of FIS within their departments, the Treasury Board Secretariat is responsible for providing the overall FIS framework.

Bumps in the road to FIS implementation

21.68 Much of the focus in the early stages of the FIS project was on the creation of an overall accounting and control framework and the development of new central systems. Departmental implementation was planned to take place in an orderly fashion over the final three years, starting in April 1999. Full implementation of FIS, including systems, accounting policies and the use of the information for management decision making, was expected to be completed by 2001–02.

21.69 Unfortunately for the FIS initiative, most departments had to move forward their implementation of new financial systems as part of their solution to the Year 2000 problem. However, without the new FIS central systems or the accrual accounting policies in place, these new departmental financial systems had to be linked to the old central accounting system using existing accounting practices. A lot of departments encountered initial reconciliation problems between their figures and those in the central systems and some of them are still working on stabilizing these interim system implementations.

21.70 In addition, planning for FIS became a low priority in departments as a result of focussing on the Year 2000 problem for their mission-critical systems. Key departmental resources were consumed on Year 2000 and were consequently unavailable for FIS planning.

21.71 With the Year 2000 problem nearing an end, the Treasury Board Secretariat and the departments are beginning to focus on getting all departmental financial systems connected to the FIS central systems and new accrual accounting policies in place, effective 1 April 2001.

21.72 As discussed in paragraph 21.42, the final, and most important, phase of FIS implementation — the use of better financial information for management decision making — is seen as longer term and requiring a change in culture.

FIS is at a critical stage — it is time to “turn up the heat”

21.73 While deputy ministers are responsible for the implementation of FIS within their departments, it is clear that the Treasury Board Secretariat and its FIS Project Office are responsible for providing the overall FIS framework, such as objectives and time frames within which departments will implement their individual components. In addition, the Secretariat is responsible for managing and reporting on the overall FIS implementation and monitoring departmental progress in implementing FIS in accordance with this framework.

21.74 These basic responsibilities of the Treasury Board Secretariat, with which we agree, are already clearly recognized and described in the government’s “FIS Book”. This document describes the objectives of the FIS project, its vision, mission and tactics as well as providing information on the governance structure. The roles and responsibilities of the Secretariat with respect to FIS are described as follows:

- “FIS is a government-wide initiative that involves central agencies and departments across government.
- “The TBS FIS Office manages and co-ordinates the development and implementation of FIS in departments and agencies under the leadership of the Deputy Comptroller General.
- “The TBS FIS Office is responsible for providing leadership across government in the implementation of the Financial Information Strategy. A key aspect of this is the complex interdepartmental co-ordination required to bring FIS to a successful conclusion.

- “The office is responsible for developing and monitoring an overall FIS Master Implementation Plan that includes all aspects of FIS. Departmental FIS readiness planning will be monitored by the FIS Office. In addition, the office is responsible for the overall FIS communications strategy...

- “...the FIS Office facilitates and co-ordinates departmental implementation. Departments will be made aware of the financial policy and systems implications required to become FIS ready. The TBS FIS Office is charged with ensuring that the necessary learning strategies and training programs are in place to make the transition to the changes resulting from the implementation of FIS.”

21.75 The government is now facing tight time frames to meet the FIS target date. Successful completion of all phases of FIS requires immediate strong leadership from the centre. We believe that the Treasury Board Secretariat FIS project management practices need to be strengthened on a priority basis as summarized below. These suggestions are consistent with the basic responsibilities of the Secretariat as set out in the FIS Book (see paragraph 21.74); the approach to handling the Year 2000 problem (see paragraphs 21.62 to 21.67); the development and implementation of new central systems by Public Works and Government Services Canada (see paragraph 21.93); and the results of a review of the shared systems initiative by the government’s Office of the Chief Information Officer (see paragraph 21.108).

21.76 FIS project management needs strengthening to move the project ahead. In late July 1999, the Treasury Board Secretariat strengthened its FIS Project Office with a dedicated senior management focus and more human and financial resources. We welcome this move because, in our view, the previous

FIS Project Office resources would not have been sufficient to effectively monitor departmental progress. Until this recent change, the FIS Project Office was staffed by a small core group consisting of three or four employees who were responsible for managing and co-ordinating the FIS project overall. We recognize that the Project Office has also drawn upon the expertise of other areas of the Secretariat when required for specific projects, such as accounting policy development and the training strategy. In addition, departmental staff have provided assistance to the FIS Project Office by sharing lessons learned. However, at this critical stage of FIS implementation, with the target date rapidly approaching, we agree that more dedicated resources are required.

21.77 We also believe that meeting the significant challenges in the coming months and years will require a more proactive central team within the Treasury Board Secretariat. The FIS Project Office needs to have additional funding for and greater influence over the implementation of FIS in departments. Some funding has recently been provided to cluster groups that are planning to build common interfaces required by participating departments in order to connect with FIS central systems in April 2000. However, the Secretariat cannot yet offer funding or human resources to departments as incentives for more action or to resolve problems at the departmental level.

21.78 The Treasury Board Secretariat needs to consider adopting an intervention capability for FIS similar to that used to deal with the Year 2000 problem. Smaller departments and agencies often lack in-house systems and policy expertise and would be very receptive to the direct help of the Secretariat. In addition, project management expertise and discipline is in short supply in government and the Secretariat could assist departments to obtain appropriate help in this area.

21.79 Overall project management needs strengthening to ensure the

The government is now facing tight time frames to meet the FIS target date.

Overall project management needs strengthening to ensure the successful implementation of FIS.

There is a need for senior government officials to get the message out on FIS.

successful implementation of FIS. Based on our review, we believe that management practices of the FIS Project Office need to include the following:

- Put in place and keep current an updated, fully integrated FIS master plan against which the FIS Project Office can manage. The FIS Project Office's existing plan was approved in early 1997 and does not reflect current circumstances.
- Strengthen ongoing risk management for FIS overall. The FIS Project Office has participated with PWGSC in managing the risks associated with the pilot work on the new central systems and could draw on this experience to develop a similar process for FIS overall.
- Obtain documented commitments between the Treasury Board Secretariat and departments establishing objectives, time frames, plans, roles and responsibilities for all aspects of departmental FIS implementation. While the FIS Project Office expects that PWGSC will require memoranda of understanding (MOU) for the connection of departmental financial systems to the new central systems, these MOUs will be or are likely to be limited in scope and duration and to not cover all aspects of FIS implementation.
- Establish a requirement for departments to submit their departmental

FIS implementation plans and to report regularly on the status of departmental FIS implementation. Attendance at cluster group meetings is currently used by the Treasury Board Secretariat as a method of monitoring departmental action. However, these meetings focus largely on general systems implementation issues and do not provide a sufficiently detailed view of individual departmental situations.

- Create a reporting framework to permit the FIS Project Office to monitor departmental implementation status and costs in a practical and constructive manner. Two surveys, one on departmental status and one on costs, have been prepared by the Treasury Board Secretariat but, as at 31 August 1999, had not yet been circulated to departments and agencies.
- Provide a change management model and assist departments that are trying to create a new management culture (see Exhibit 21.4 for one view of change management).

21.80 Selling the benefits of FIS needs to start now. There is a need for senior government officials in the Treasury Board Secretariat and in leading departments to get the message out on FIS. In particular, they need to ensure that senior management in departments and agencies fully understand FIS and its relationship to comptrollership, and the importance of placing appropriate priority

Exhibit 21.4

Key Areas of Leadership for the Implementation of Change

- 1 Establish a sense of urgency
- 2 Form a powerful guiding coalition
- 3 Create a vision
- 4 Communicate the vision
- 5 Empower others to act on the vision
- 6 Plan for and create short-term wins
- 7 Consolidate improvements and produce still more change
- 8 Institutionalize new approaches



Source: Adapted from John Kotter's book: *Leading Change* (Harvard Business School Press, 1996)

on its successful implementation. To date, there has been little promotion of FIS at senior levels. Secretariat officials told us that they plan to focus on this after the accrual appropriations issue has been resolved, currently planned for the end of 1999. As a result, the much-needed promotion of FIS at senior levels would not commence until early 2000. There is a risk that this may be too late for the 2001 target date.

21.81 Program managers and senior management in departments and agencies are looking for clear examples of the benefits of FIS. The Treasury Board Secretariat, with overall responsibility for FIS, is best positioned to help departments by determining and communicating this information government-wide. But this needs to be done now to get program and senior managers on side and to begin the change management process.

21.82 Departmental senior full-time financial officers are aware of the fact that accrual-based government-wide financial statements are to be prepared in 2001–02. As suppliers of the information required by the centre to produce these financial statements, they understand well the need for financial systems and accrual accounting policies to be in place by that time.

21.83 However, the Treasury Board Secretariat needs to continue its efforts to overcome the image of FIS as “merely an accounting exercise” and to emphasize the benefits to departmental managers. We are concerned that if the production of the financial statements in 2001–02 is seen as an objective for short-term success, this may reinforce the image of FIS as an accounting exercise. FIS, in its totality, will not succeed if it continues to be seen by program managers as simply an accounting exercise designed to improve the government’s annual financial statements rather than as a tool to provide managers with better financial information for day-to-day decision making.

21.84 Guidance to departments needs to be finalized. As at 31 August 1999, the Treasury Board Secretariat had not yet finalized its accrual accounting policies for FIS. We were informed by the Secretariat that the existing draft accounting standards on general accrual accounting policy and principles as well as on capital assets will be finalized by September 1999. Departments are looking for more guidance from the Secretariat on other accrual accounting issues. In this respect, Secretariat officials informed us that they expect to have an accounting manual in place by the end of December 1999.

21.85 As described in paragraph 21.109, the issue of accrual appropriations has yet to be resolved. The Secretariat plans to complete its consultations by November 1999.

21.86 The Secretariat has developed a good training framework and the first phase of training to financial officers is now under way. Further training, particularly for program managers and senior management, will be provided closer to the FIS implementation date.

21.87 The Treasury Board Secretariat should immediately put in place, communicate throughout government and maintain an updated, fully integrated master implementation plan for the Financial Information Strategy (FIS). The plan should indicate what can be realistically accomplished by the target date of April 2001 as well as target dates for the completion of remaining aspects of FIS implementation.

21.88 The Treasury Board Secretariat should immediately obtain documented commitment from departments to implement all aspects of the Financial Information Strategy.

21.89 The Treasury Board Secretariat should obtain and review departmental FIS implementation plans.

The Treasury Board Secretariat needs to continue its efforts to overcome the image of FIS as “merely an accounting exercise” and to emphasize the benefits to departmental managers.

The Treasury Board Secretariat has not yet finalized its accrual accounting policies for FIS.

The FIS central systems were successfully piloted in the fall of 1998 and implemented in April 1999.

Exhibit 21.5

FIS Central Systems: Lessons Learned

Key lessons learned from the central systems development and implementation included the following:

- Memoranda of understanding got senior management committed to the plan.
- Ongoing risk management with the active participation of the Treasury Board Secretariat and the pilot departments was critical. For example, Public Works and Government Services Canada recently identified, and is working to mitigate, a number of transition issues. These relate to the reconciliation of interdepartmental settlements by non-FIS departments and the mapping of departmental coding to the government-wide chart of accounts.
- A fully integrated project plan combining the efforts of all of the parties was important in keeping the project on track.
- Ongoing progress reporting was essential.
- Regular team meetings were held, increasing in frequency as required.
- Problem reporting and risk mitigation was carried out in a disciplined way.
- Pre-established evaluation criteria provided the various parties with clear expectations for the implementation.

21.90 The Treasury Board Secretariat should establish a reporting framework to permit the FIS Project Office to monitor departmental FIS implementation progress and costs, and to intervene if difficulties arise.

21.91 The Treasury Board Secretariat should consider providing additional funding and other resources to departments where the need for such an intervention can be clearly established.

21.92 The Treasury Board Secretariat should develop and implement a comprehensive communications plan to market FIS to senior government managers and provide guidance and consultation regarding change management and lessons learned (for example, case studies).

Treasury Board Secretariat's response:
The Treasury Board Secretariat developed a Master Implementation Plan for FIS in early 1997 and has been guided by it since then. In the summer of 1999, the Secretariat decided to increase the focus on implementation of the Strategy, in part by dedicating more resources to it. As the

implementation plan is updated, the Secretariat will consider the recommendations of the Auditor General.

FIS Central Systems

Strong risk and project management ensured successful implementation of FIS central systems

21.93 The FIS central systems were successfully piloted in the fall of 1998 and the decision to proceed with implementation was made in January 1999. Successful implementation took place on time in April 1999 and, with considerable effort by all of the parties involved, with very few problems. Public Works and Government Services Canada documented the key lessons learned from this systems implementation. These are summarized in Exhibit 21.5.

The FIS Project Office does not want a tidal wave of implementation in 2001

21.94 To reduce the number of departments connecting to the new FIS central systems in 2001, and to encourage early development of FIS interfaces for the major cluster groups, a number of departments were asked to implement their FIS-compliant financial systems for April 2000. The selection was still being finalized in early August 1999; as at 31 August 1999, 23 departments had been identified.

21.95 However, Public Works and Government Services officials advised us that, based on their experience with the pilot implementation, a minimum of nine months is needed just to implement the interfaces to the FIS central systems. Exhibit 21.3 indicates the key implementation dates identified by the Department.

21.96 As discussed in paragraphs 21.50 and 21.51, the government made a risk-based decision to proceed with the implementation at these 23 departments in April 2000.

21.97 In April 1999, 16 departments connected to the new central systems. Even with the 23 departments implementing FIS-compliant systems in April 2000, there remains approximately 55 to implement their FIS-compliant systems in 2001. In addition, all of the departments and agencies are required to have their accrual accounting policies implemented by April 2001.

21.98 Public Works and Government Services Canada is concerned about this large number implementing their systems and policies at one time. Officials believe that, given testing and other resource requirements, the Department can handle about 30–35 departmental implementations in any one year. This means that there is a very high risk of overload and a corresponding impact on the overall FIS schedule.

21.99 In addition, the old central accounting systems are funded only to the end of 2001–2002. A schedule delay would require the continued use of these systems at an estimated additional cost to the government of approximately four million dollars per year.

21.100 Connecting new departmental systems to new central systems represents a relatively small subset of the total systems aspects of the Financial Information Strategy. The largest part of systems implementation involves configuring the new departmental systems to meet departmental financial information needs under FIS.

Cluster Groups

The government officially endorsed seven financial systems

21.101 The Treasury Board Secretariat created a “shared systems initiative” to reduce the number of major administrative systems in use in the Government of Canada. These shared systems included systems in the human resources, financial,

materiel management and administrative areas. For example, the government officially endorsed seven financial systems, representing a reduction from the 30 systems in place previously, from which departments could choose based on their size and business needs.

21.102 The government created cluster groups for each of the shared financial systems where those departments that are implementing the same financial system meet to discuss systems-related issues and to develop and share common solutions.

Cluster group performance has been mixed

21.103 To date, cluster group management and progress have been mixed. We note that the Treasury Board Secretariat has recently taken action to correct the problems associated with management of the clusters. We examined the operations of the Common Departmental Financial System (CDFS), Oracle Financials and SAP cluster groups as part of this audit.

21.104 The CDFS cluster group is tightly controlled by PWGSC, its lead player and service provider. The CDFS system is FIS-compliant and provides basic financial management capability. The CDFS cluster group plans to add more functions in future releases.

21.105 The Oracle Financials cluster group consists of four departments of relatively equal size plus a number of smaller ones. These departments are working well together and have developed a five-year plan. The interim goal is for all of the departments to migrate to a FIS-compliant version of the software while working toward the ultimate goal of implementing a common application platform.

21.106 The SAP cluster group consists of 15 departments. Until early 1998 they were not well co-ordinated at the senior level. At that time, a Steering Committee was formed comprised of Assistant

Public Works and Government Services Canada is concerned about the large number of departments implementing their systems and policies at one time.

The Treasury Board Secretariat has recently taken action to correct the problems associated with management of the clusters.

We believe that the regular sharing of lessons learned and other useful information could enhance the benefits of the shared systems initiative.

The Secretariat plans to complete its consultations on accrual appropriations in November 1999, at which time it will decide upon a future course of action.

Deputy Ministers from the 15 departments and co-chaired by the Deputy Comptroller General. That Committee recognized the need for stronger leadership of the cluster group and a full-time executive director, reporting directly to the Deputy Comptroller General, was recruited in early 1999.

21.107 Until recently, inter-cluster communications and sharing has been weak and ad hoc. We believe that the regular sharing of lessons learned and other useful information could enhance the benefits of the shared systems initiative.

21.108 The Office of the Chief Information Officer (CIO) reviewed the shared systems initiative, including the shared financial systems, in early 1999. The key findings of its May 1999 report noted very limited government-wide leadership, the lack of a management framework, no strategic and business planning at the corporate level, some funding issues and no ongoing monitoring of the initiative's performance. The Treasury Board Secretariat is preparing an action plan to respond to these issues and a shared systems steering committee has been established by the CIO.

Follow-up of FIS-Related Chapters and Public Accounts Committee Report

21.109 After the publication of Chapter 18 of our 1998 Report to Parliament, and the Public Accounts Committee report on that chapter, the Treasury Board Secretariat prepared a paper on accrual appropriations options that will form the basis of the consultations with stakeholders. The paper is currently being reviewed internally prior to starting external consultations. The Secretariat plans to complete its consultations in November 1999, at which time it will decide upon a future course of action.

21.110 The Public Accounts Committee recommended that the Treasury Board Secretariat monitor the progress of FIS across government, report regularly to Parliament on progress, specifying any major impediment to meeting the target date of 2001. The Secretariat indicated that it would report to Parliament through its fall Performance Report. We are not aware of any other status reports being tabled, nor of any information being provided to Parliament on impediments to completing FIS on time. In response to a request by the Committee Chairman for a FIS update, the President of the Treasury Board replied in his letter of July 1999 that "everything possible is being done to implement FIS on April 1, 2001."

21.111 The Public Accounts Committee also requested that the Treasury Board Secretariat provide Parliament, on a regular basis, with cost estimates of FIS as it is being implemented. To date, no reports on costs have been tabled. The President of the Treasury Board's July 1999 letter indicated that a cost survey has been developed. However, there is no timetable given for its completion.

21.112 In Chapter 3 of the April 1997 Report to Parliament, the Office reported on the management of the government's accounting function from a central agencies point of view. Because of its relationship to FIS, we have followed up, and are reporting here, on the government's action on the recommendations made in that chapter. The detailed recommendations from Chapter 3, the government's action and our assessment of that action are included in the Appendix. In summary, the government is in the process of implementing the Financial Information Strategy (FIS), which, through its objectives, should address many of the recommendations made in that chapter. Overall, however, we believe that the government needs to do more to address the chapter's recommendations. By doing

so, it would be in a better position to ensure that the objectives of FIS will be achieved.

Conclusion

21.113 With a target implementation date less than two years away, departments are just starting to focus on FIS. At the time of our audit, while most departments had implemented new financial systems, they still had a lot of work to do to prepare these financial systems and to implement the accrual accounting policies to meet FIS requirements. Strategies for preparing managers to use the information provided by FIS to strengthen management decision making are not yet in place. We are also concerned that FIS is not seen as a high priority by senior managers.

21.114 In our view, the Treasury Board Secretariat, overall project manager for FIS, needs to assume a greater leadership role to bring FIS to fruition. In particular, its FIS Project Office will need to put in place and keep current an updated, overall implementation plan, use appropriate risk management capabilities, monitor implementation by departments and intervene constructively if problems arise. In addition, it will need to provide departments with required accounting policies and manuals, which are currently being developed, and assist departments in

developing an appreciation of the use of FIS in day-to-day management.

21.115 Public Works and Government Services Canada (PWGSC) effectively carried out the development and implementation of new central systems. PWGSC and its major partners, the Secretariat and Revenue Canada, worked together to conclude a successful pre-production pilot of those new systems. The Department and its partners established a detailed plan and risk management capability, monitored progress and intervened when necessary, and met key target dates.

21.116 There is some activity under way in response to our recommendations in Chapter 18 of our 1998 Report and in the Public Accounts Committee's Report on that chapter. These activities have not yet been completed and we will continue to monitor and report on progress.

21.117 In our view, it is important that the momentum created across government to deal with the Year 2000 problem now be carried forward to FIS. New financial systems and accounting rules need to be put in place within the next two years. However, victory must not be declared too early. Officials throughout government need to be encouraged to use the more businesslike and timely financial information that FIS will provide for day-to-day program management and accountability.

With a target implementation date less than two years away, departments are just starting to focus on FIS.

Officials throughout government need to be encouraged to use the more businesslike and timely financial information.



About the Audit

Objectives

The objectives of the audit were to:

- assess the state of FIS readiness in a selection of departments;
- review the management of FIS overall by the Treasury Board Secretariat;
- examine the implementation of the new central systems; and
- follow up other significant issues raised in our September 1998 chapter as well as the recommendations made in Chapter 3 of the April 1997 Auditor General's Report.

Scope

The scope of the audit included a detailed review of the implementation of FIS in seven departments — Revenue Canada, Public Works and Government Services Canada, Correctional Service Canada, Transport Canada, Finance/Treasury Board Secretariat, Fisheries and Oceans and the Department of Foreign Affairs and International Trade. In addition, as part of our annual audit of the government's summary financial statements, we conducted a survey of the status of FIS implementation at 24 of the largest departments and agencies (including the departments selected for detailed review). We also reviewed the management and plans of the SAP, Oracle Financials and Common Departmental Financial System (CDFS) financial system cluster groups.

The scope of the audit at the central agencies included a review of the management of FIS overall by the Treasury Board Secretariat as well as the completion of the central systems pilot testing and the subsequent implementation by Public Works and Government Services Canada.

Criteria

The high-level criteria for the audit were as follows:

Departments

- Departmental project approval includes consideration of risks identified and project cost estimates.
- Departmental plans consider policy, systems, reporting, audit, operational and the change management (including management support, communications, training and roles and responsibilities) implications of FIS.
- FIS implementation plans identify resources required and provide detailed project management plans, systems implementation plans, policy development plans, and change management plans.

Treasury Board Secretariat

- The Financial Information Strategy Project is managed and monitored across departments, in particular with respect to ongoing risk management, departmental readiness, training, policies and guidelines, and cost estimates.

- The Treasury Board Secretariat provides periodic updates on the FIS implementation to Parliament and the Public Accounts Committee.
- The government is following up and acting upon points raised in previous chapters on the Financial Information Strategy, including accrual appropriations.

Cluster Groups

- The cluster groups are adequately resourced, have a clear mandate, and work effectively to address common requirements.

FIS Central Systems

- The government is following up and acting upon points raised in previous chapters on the Financial Information Strategy, including the development and implementation of FIS central systems.

These summary criteria were supported by more specific sub-criteria that were used by the audit team in carrying out its field work.

The criteria for the audit were primarily drawn from the Treasury Board Secretariat Departmental Readiness Checklist, which is a generic list of implementation tasks that an interdepartmental committee prepared for use by departments. These criteria were supplemented by change management criteria drawn from published academic and industrial sources. The recommendations in the Public Accounts Committee's report to Parliament provided additional criteria related to the management of FIS overall.

Audit Team

Assistant Auditor General: Ronald C. Thompson

Principal: Eric Anttila

Directors: David Willey and Marvin Schwartz

Olga Dupuis

Philippe Martineau

Martin Ruben

For more information, please contact Eric Anttila.

Appendix

Follow-up of the Recommendations in Chapter 3 of the April 1997 Report of the Auditor General to Parliament

Overall conclusion: The government is in the process of implementing the Financial Information Strategy (FIS), which, through its objectives, should address many of the recommendations made in Chapter 3 of the April 1997 Report of the Auditor General. Overall, however, we believe that the government needs to do more to address the chapter's recommendations. By doing so, it would be in a better position to ensure that the objectives of FIS will be achieved.

Recommendation	Action taken by the government	Assessment of action taken
The government should strengthen its capability to analyze and interpret government-wide financial information on an ongoing basis throughout the year. (paragraph 3.72)	<p>The government established a process known as the Fiscal Monitor Committee to review the monthly analysis of tax revenues. On the expenditure side, an annual Letter of Protocol formalizes the ongoing recording of significant accruals and allowances. As a result, the Monthly Statement of Financial Operations and the Fiscal Monitor are now prepared following the same modified accrual accounting policies as are used for the annual financial statements. Financial reporting therefore provides a much more accurate representation of the results of financial operations throughout the year. In addition, a senior Spending Monitor Committee meets on a weekly basis to discuss emerging spending pressures and issues supported by ongoing staff meetings and contacts with departments.</p>	<p>Action taken by the government to date, specifically in the area of government-wide expenditure analysis, does not completely address the recommendation made in the chapter. However, some progress to date has been noted. We still believe that this capability is integral to the government's ability to prepare its annual Budget, monthly forecasts of expenditures and support other important resource allocation and evaluation processes.</p>
To enhance usefulness and credibility, the government should review its strategy for publishing financial statements during the fiscal year. (paragraph 3.77)	<p>The government concluded that it should continue the practice of producing monthly statements. In addition, the government commenced producing its monthly statements that include more accrual accounting information and an interim statement of assets and liabilities.</p>	<p>By reviewing its strategy and concluding that no change should be made regarding the frequency of the interim financial results, the government has addressed the recommendation.</p>
To improve timeliness, the financial statements during the year should be published within no more than one month after the period end. Upon full implementation of FIS, the audited financial statements included in the Annual Financial Report of the Government of Canada should be published within no more than three months after the fiscal year end, with the Public Accounts of Canada tabled in Parliament as soon as possible thereafter. Annual and monthly reporting time frames should be made public in advance so that users can know when to expect financial information. (paragraph 3.79)	<p>Significant improvements in the timeliness of reporting monthly and annual financial results will be realized once the Financial Information Strategy, including state-of-the-art departmental and central financial systems, is fully implemented in 2001–02. During the three-year transition period to full accrual accounting, parallel systems and policies will need to be maintained, making it extremely difficult to realize earlier reporting, particularly relating to monthly results.</p> <p>The government is committed to following the IMF Manual of Fiscal Transparency, which recommends that monthly statements be produced no later than the 20th calendar day of the second month following.</p> <p>The latest possible release dates for the monthly <i>Fiscal Monitor</i> are now made public.</p>	<p>While the government has established reporting time frames in advance, we believe that the timeliness of the monthly financial statements could improve even before FIS accounting systems have been implemented. Opportunities exist within the current framework to publish the financial reports earlier along with our audit of them.</p> <p>The government could therefore be doing more to address this recommendation at this time.</p>

Recommendation	Action taken by the government	Assessment of action taken
<p>The government should assess the capability of accounting groups within departments and agencies to implement new systems and accrual accounting, and should provide strong functional guidance to them, particularly during the period of transition. (paragraph 3.84)</p>	<p>The Treasury Board Secretariat has issued a number of accounting policies and carried out a number of general presentations and workshops for both accounting and non-accounting groups in departments and agencies. At the workshops, the Secretariat has obtained an inventory of skill sets of employees. The information was used to develop a FIS Learning Framework including a curriculum of courses for financial and non-financial staff. The initial phase of courses designed to bolster the skills of the finance community has been developed. Work on the next phases, focussed on finance for non-financial managers, is underway.</p>	<p>Although the Treasury Board Secretariat has responded to the recommendation by developing a training strategy for existing employees, it is not clear whether that is the entire solution or if additional outside resources with the necessary expertise may be required. With the scarcity of accounting resources throughout government, the lead-time required and the cost of acquiring and training accounting personnel, the Treasury Board Secretariat should be doing more now to ensure that departments will be well positioned to operate in the new accrual accounting environment.</p>
<p>It continues to be our view that the government should amalgamate its central accounting function. The newly amalgamated function should be led by an individual with overall authority to address the significant challenges posed by the accounting changes now under way and address the other recommendations in this chapter (Chapter 3, April 1997). The individual should have appropriate resources and be clearly accountable and responsible for addressing these challenges in a timely manner. (paragraph 3.95)</p>	<p>One of the steps in the FIS Readiness Checklist for departmental FIS implementation requires departments to perform a skills assessment on key functions, including accounting and systems. This assessment should allow departments to gauge the need for temporary engagement of private sector resources to assist in the implementation of FIS until departmental personnel have gained sufficient expertise.</p>	<p>The government disagreed with this recommendation and has opted to maintain its current organizational structure.</p> <p>Although we recognize that the current arrangement is working, we continue to feel that it does not work as well as it could. Based upon the work we have performed to date, the slow pace of implementation of FIS in the departments, as well as the significant challenges still faced by the government to implement accrual accounting, we continue to recommend the amalgamation of the function.</p>

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 22
Attributes of Well-Managed Research Organizations

November 1999

Report of the
Auditor General
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Chapter 22
Attributes of Well-Managed Research Organizations

November 1999

This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 22

Attributes of Well-Managed
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Attributes of Well-Managed Research Organizations

Main Points

22.1 We found that well-managed research organizations share a number of attributes that we have grouped under four themes:

- They **focus on people**, recruiting, developing and retaining the right mix of talent in a positive and supportive environment.
- They show **leadership**, aligning themselves with the needs of those who depend on them for results, achieving buy-in of the vision, values and goals, and undertaking the right research at the right time and at the right investment.
- They **manage research** to ensure excellence and results, the leveraging of resources, and the capture of organizational learning.
- They strive for a high level of **organizational performance**, being widely known and respected, and meeting the needs of those who depend on them for results.

22.2 We developed the attributes following research and consultation with research managers in Canada and the United States. The attributes are not a recipe for action but rather statements of the direction that management action should take. They are supplemented by examples of practices used by organizations we visited.

22.3 While the attributes describe ideal outcomes, and are therefore not attainable, they are stated so that progress toward the ideal is observable and measurable. In our view, the extent to which an attribute is demonstrated by an organization is a measure of the quality of its management.

Background and other observations

22.4 The federal government invested nearly \$5.5 billion in science and technology (S&T) in 1998–99. Of that amount, \$3.2 billion was spent by federal research organizations, with the balance being paid to outside organizations to undertake research and development and related scientific activities.

22.5 In *Science and Technology for the New Century: A Federal Strategy* (1996), the federal government recognized the need for better management of S&T activities and provided new governance mechanisms and a set of general operating principles to improve S&T management across and within departments and agencies. Our work complements and reinforces the Strategy by describing what good management should look like in a research organization.

Introduction

22.6 Federal science and technology (S&T) activities play an important role in the fulfilment of government responsibilities in areas such as health and safety, protection of the environment, communications and social and economic development. In 1998–99, the federal government spent an estimated \$5.5 billion on S&T activities. Exhibit 22.1 provides a breakdown of these expenditures by performing sector.

22.7 Of the \$5.5 billion, the government spent \$3.2 billion or 59 percent on intramural activities — that is, activities carried out primarily by departments, agencies and Crown corporations of the federal government. Of that amount, \$1.59 billion (29 percent of the total activities) was spent on research and development — that is, creative work undertaken in a systematic way to increase the stock of scientific and technical knowledge and to use that knowledge in new applications; and

\$1.64 billion (30 percent of the total activities) was spent on research-related activities — that is, activities that complement or extend research and development by generating, disseminating and applying new scientific and technological knowledge. Good management of these S&T activities is critical for the federal government to achieve expected results.

Our past work on science and technology

22.8 In 1994, we audited the science and technology activities of a number of departments and agencies. We identified a number of concerns relating to the management of research, both overall and within departments and agencies.

22.9 At the government-wide level, we identified a need for clear priorities and direction, clear performance expectations and action plans, effective co-ordination and oversight, leadership that transcends departmental mandates, and better information for Parliament and the public on S&T activities and

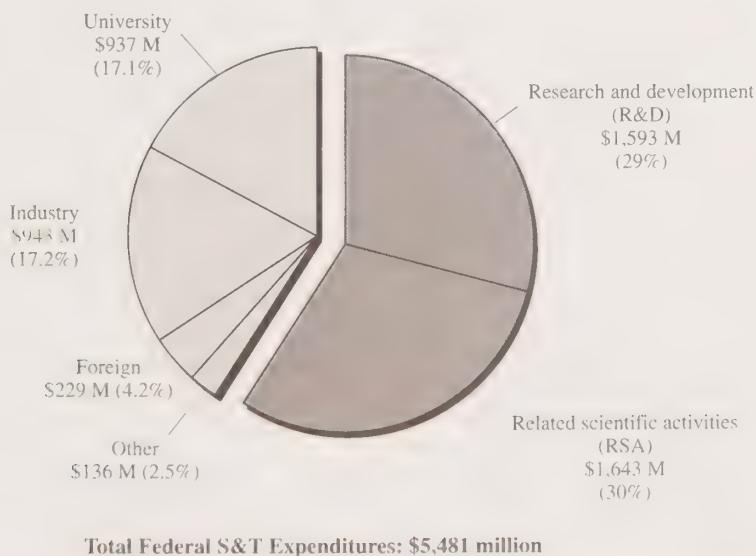


Exhibit 22.1

Federal Government Expenditures on Science and Technology (S&T) Activities by Performing Sector – 1998–99

S&T done by non-federal organizations \$2,245 M (41%)

S&T done by federal organizations \$3,236 M (59%)

This exhibit shows that 59% of federally funded S&T activities are actually performed by federal organizations; the remainder are performed by external organizations. These figures do not include payments to the Canada Foundation for Innovation.

Source: Statistics Canada

We have been concerned about the management of science and technology in several recent reports.

Research activities, by their very nature, pose unusual challenges to managers.

performance. At the departmental level, we identified the need to set goals that focus more on results, to establish priorities based on an assessment of client needs and opportunities in the sectors, to strengthen human resources planning and the development of research management capability, to establish clear accountability for results and to promote their use, and to improve project selection and review processes and project management practices.

22.10 In 1996, the federal government released a federal strategy for science and technology entitled *Science and Technology for the New Century: A Federal Strategy* (S&T Strategy), partly in response to our audits. The Strategy outlined three goals for the federal investment in S&T: sustainable job creation and economic growth, improved quality of life, and advancement of knowledge. It also set out government-wide operating principles to guide departments and agencies in the management of their science and technology activities. At the same time, to support the implementation of these principles, the government also released the *Framework for the Human Resources Management of the Federal Science and Technology Community* (HR Framework). The Framework was designed to help government develop and implement policies and tools that science managers could use to help align their organizations and S&T staff with the science direction and business of departments.

22.11 In 1998, we reviewed the government's progress in implementing the commitments of the S&T Strategy. The 1998 chapter reported that progress in establishing the elements required to improve the management of the federal S&T effort had been slow. The management regime set up to oversee the federal S&T effort was not yet working as intended. Departments we reviewed were making varying degrees of progress in acting on the operating principles

enunciated in the Strategy. We identified three areas requiring special attention: planning, priority-setting and performance reporting for mission-driven, results-based research; use of external peer review to ensure scientific excellence; and the development of strategies for the use of partnerships, both external to government and across departments.

22.12 We reported in April 1999 on a follow-up of the management of federal S&T personnel. We concluded that the science and technology community is showing leadership and perseverance in dealing with human resource management issues that we identified in 1994. But considerable challenges remained, particularly in coping with the impact of the current demographic profile, in attracting and recruiting new talent, and in retaining experience.

22.13 Our work to date pointed to the need for a description of what a well-managed research organization looks like. This study uses the guidance provided in the S&T Strategy, the HR Framework and other sources to create a set of ideal outcomes of research management. We call these ideal outcomes *attributes*. The extent to which an attribute is demonstrated by an organization is an indication of the quality of management.

Management challenges in the research environment

22.14 We looked at some of the challenges for managing research from two perspectives: generic challenges common to both public and private sector research managers, and those that are more specific to government research.

22.15 Generic challenges. Research activities, by their very nature, pose challenges to managers. Whether in the public or private sector, setting priorities and articulating target impacts or end results are difficult. There are several reasons for this:

- There is uncertainty about where the most valuable discoveries lie.
- There is risk associated with scientific uncertainty.
- The nature of research is serendipitous and results are unpredictable, given the pursuit of the unknown (it is not uncommon to have findings that are useful in themselves but are not aligned with expected results).
- The time frames are often long before the outcomes or impacts of research become evident.

22.16 These characteristics also mean that research managers have a significant challenge in communicating the true worth of research, especially to non-scientist decision makers, and the benefits of investing in it. The need to constantly justify the value of the investment in research is an ongoing challenge in both the public and private sectors.

22.17 Mission-oriented research organizations conduct research to support their mandates. Their work is a blend of requirements-driven and related exploratory research. The majority of effort is focussed on achieving target outcomes or end-results. However, some effort is invested in exploratory research to identify emerging needs and opportunities and new and better approaches to addressing identified needs. Some of the challenges that managers in mission-oriented research organizations face include: identifying their constituencies and their expectations and developing effective research programs to respond to these expectations; balancing the need to provide researchers with some freedom to explore (to nurture creativity and innovation) with the requirement to deliver expected results; and using appropriate methods to monitor quality and relevance.

22.18 An emerging challenge is the growing use of collaborative arrangements

and partnerships involving researchers from different organizations, different sectors and even different countries. Among the factors driving this trend are the need to bring together expertise from different disciplines to tackle complex research questions, and the need to share research costs. As a result, managers need to develop new approaches to managing research, to protecting intellectual property, and to communicating results in a useful form.

22.19 Challenges in the management of government research. The federal S&T Strategy identified the following challenges for managers of government research:

- using foresight (the ability to anticipate future challenges and to make adjustments while staying focussed on long-term goals), risk assessment and prevention practices to address issues before they become problems;
- putting in place effective mechanisms to co-ordinate research activity horizontally across departments and with other sectors (climate change, polar science and biotechnology are examples of issues requiring horizontal management); and
- striving for greater transparency and openness through the regular use of independent peer review for validation of quality, and expert client/stakeholder review for validation of relevance.

22.20 The federal strategy stated the government's intention to adopt measures to strengthen the management of government research activities, such as the establishment of clear S&T targets and objectives, performance measurement indicators and evaluation frameworks. Departments and their research organizations are currently working to implement these measures. Their task is made more challenging by the increasingly complex nature of many important research questions that span the mandates of many departments (for

An emerging challenge is the growing use of collaborative arrangements and partnerships.

**Recruitment, retention
and rejuvenation
challenges are
particularly acute in
the public sector.**

example, the science of climate change). New approaches and structures, linking the performers and users of the research, are required to better manage these research activities and to monitor client satisfaction.

22.21 Measures to strengthen the management of government research activities bring managers and researchers face to face with another challenge — namely, preserving the bicultural (scientific and administrative) character of the organization. The research culture is based on strongly held scientific values, many of which are derived from the broader scientific community. Among these is the deep desire to learn and acquire knowledge for its own sake. The challenge for research managers in the public sector is to gain researcher acceptance that government research is first and foremost mission-oriented, not just knowledge-driven, and that to achieve expected results, research must be actively managed.

22.22 Unfortunately, over-emphasis of administrative imperatives and processes can overwhelm scientific values, stunt scientific curiosity, or drive out the very creativity that is needed to address complex research questions. As in most things, balance is needed: managers must recognize and work with the deeply held scientific values of the research culture; and researchers must appreciate and accommodate the administrative imperatives under which managers operate.

22.23 All sectors are facing recruitment, retention and rejuvenation challenges, but these are particularly acute in the public sector at present. Expenditure and work force reductions and expanding opportunities in other sectors have led to demographic profiles that could compromise the government's S&T capacity. Public sector managers are exploring more flexible recruitment

measures, appropriate compensation packages, and ways to improve work environments.

22.24 The government identified a new role for itself in the S&T Strategy, namely that of information analyst, knowledge disseminator and network builder. Fulfilling this role effectively requires the strategic management of intellectual capital across the federal system. Intellectual capital is the interplay of the knowledge assets of an organization — the structures, processes and policies that nurture the creation, sharing and exploitation of knowledge. It includes the talent of employees, the management systems, and the relationships with constituencies. Because know-how resides in people, and is reinforced in processes and interactions, an organization needs to have a strategy to manage its intellectual capital and that strategy should align with its mission and overall strategy.

Focus of the study

22.25 The purpose of our study is twofold:

- to inform Parliament about attributes of well-managed research organizations that can be used to assess the management of research activities in federal departments and agencies; and
- to provide guidance to federal research managers on ideal outcomes of good management, and examples of practices to achieve the performance ideals described by the attributes.

22.26 This purpose is fully in line with the Office's strategic priority to contribute to necessary changes in the public service, outlined in our Report on Plans and Priorities. We plan to use the attributes in future value-for-money audits of federal research activities. Further details on this study are found at the end of the chapter in **About the Study**.

Observations

Definition of Attributes

22.27 The idea of “attributes” comes from the question, “How could you tell if a research organization is well-managed?” We were interested in exploring how senior managers of research organizations would know whether they were doing a good job. What qualities or attributes would be evident if they were?

22.28 Having said that, the attributes are not a recipe for action. They are meant to capture performance ideals that organizations strive to achieve, but will never fully reach. As such, they are offered as statements of the direction that management action should take, rather than as a plan for getting there.

22.29 The attributes are stated so that progress toward the ideal is observable and even measurable. By design, the attributes can be used by research managers in developing performance

improvement strategies, and they can be used by auditors and evaluation experts in assessing the management of a research organization. The extent to which an attribute (appropriately modified to suit a specific organization’s circumstances) is demonstrated, is a measure of the quality of management.

22.30 The attributes are presented in Exhibit 22.2. They are grouped around four key perspectives on organizational success: people focus, leadership, research management and organizational performance. These perspectives tie together the attributes around themes we identified in the course of our work. Because the first three perspectives produce the fourth — organizational performance — they are critical in their own right and demand an equal amount of management attention. Conversely, organizational performance directly impacts the other three perspectives. For example, organizational success nurtures a focus on people, strengthens leadership and facilitates research management.

People Focus

1. Management knows what research and other talent it needs to accomplish the mission, and recruits, develops and retains the right mix of people.
2. Employees are passionate about their work, have confidence in management, and are proud of their organization.

Leadership

3. The current and anticipated needs of dependent constituencies drive the organization and its research programs.
4. Employees and dependent constituencies share management’s vision, values and goals.
5. The portfolio of programs represents the right research, at the right time and at the right investment.

Research Management

6. Research projects embody excellent science, involve the right people, are on track and within budget.
7. Research projects leverage external resources.
8. Organizational knowledge is systematically captured and turned into needed work tools.

Organizational Performance

9. The organization is widely known and respected.
10. The organization meets the needs of dependent constituencies.

Exhibit 22.2

The Attributes

Source: Office of the Auditor General of Canada

22.31 Similarly, the individual attributes are interdependent and work together to provide an overall picture of good research management. While there is overlap among the attributes, each one sets out an ideal outcome for a different dimension of the management of research.

22.32 We have used the word “right” several times in the attributes. The idea is that when management is faced with choices, some are better than others and one, the right or ideal one, is best of all. Management is responsible for deciding what the right option is, and does that by reference to relevant standards — in particular, its vision, goals and values.

Approach to the Development of Attributes

22.33 We developed the attributes through an iterative process. Exhibit 22.3 provides a graphic representation of our approach.

22.34 We based our preliminary set of attributes on the operating principles of the government’s S&T Strategy, the ingredients of the HR Framework, the quality management criteria developed jointly by the National Quality Institute and the federal government, and the attributes of effectiveness developed by CCAF-FCVI Inc. (a Canadian research and educational foundation dedicated to building knowledge for meaningful

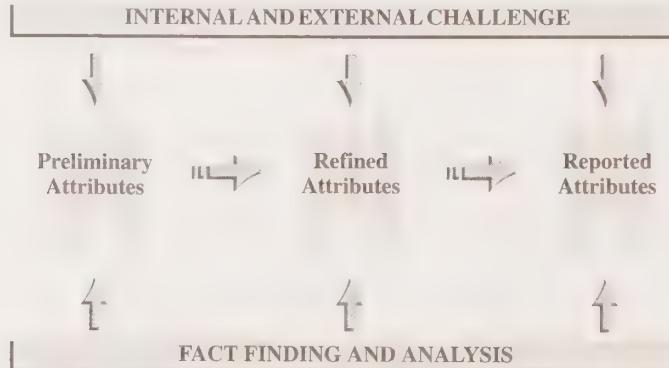
accountability and effective governance, management and audit.)

22.35 We refined the attributes through fact finding and analysis and by subjecting the evolving attributes to internal and external challenges. We conducted a review of the research management literature and analyzed several documents and reports published by the federal government. The following federal resources significantly influenced our thinking:

- the report of the Independent Review Panel, *Modernizing Comptrollership in the Government of Canada*, which emphasizes open, accessible, value-driven and results-oriented government;
- a document under development by federal science-based departments entitled *Best Practices for the Conduct, Management and Use of Science in the Government of Canada*;
- *Guide to Good Management 1998 — An Evolving Approach*, recently published by Natural Resources Canada;
- the recently released Council of Science and Technology Advisors report entitled *Science Advice for Government Effectiveness*; and
- draft S&T management core competency profiles from the federal working group on the management of S&T, and the National Water Research Institute’s *Development Resource Guide for R&D Management*.

Exhibit 22.3

Approach to Identifying Attributes



Source: Office of the Auditor General of Canada

22.36 We took into account guidance on managing for results and other aspects of effective management in reports published by federal departments, our own Office, and organizations in other countries.

22.37 Our evolving set of attributes was subjected to various tests and challenges. We sought input from our own advisory committee, from research managers at different levels in federal departments, and from other knowledgeable sources such as the American Association for the Advancement of Science, the National Science Foundation, and the U.S. General Accounting Office.

22.38 We visited a selection of known and respected R&D organizations in Canada and in the U.S. to test the attributes and to obtain examples of supporting practices. The organizations we visited were the following:

- Alberta Research Council
- Argonne National Laboratory, U.S. Department of Energy
- Army Research Laboratory, U.S. Department of the Army
- Office of Research and Development, Environmental Protection Agency
- Goddard Space Flight Center, NASA
- Merck Frosst Canada and Co.
- U.S. National Institute of Standards and Technology
- Nortel Networks

Information about these organizations is provided in Exhibit 22.4.

22.39 We assumed that research managers in the federal government were generally aware of each other's practices but might find it helpful to learn about

Exhibit 22.4

Research Organizations We Visited

The Alberta Research Council



The Alberta Research Council (ARC) is a provincial corporation owned by the government of Alberta. Its purpose is to advance the economy and well-being of Alberta by providing technology and innovation to meet current and emerging needs of industry and government. It performs applied research and development, and provides expert advice and technical information to a diverse range of clients from small start-up firms to multi-national corporations, and government departments and agencies. ARC is recognized for its capabilities in the following sectors: agriculture, energy, forestry, biotechnology, environment, information technology, and manufacturing.

Argonne National Laboratory



Argonne National Laboratory is a multi-program research and development centre owned by the U.S. Department of Energy and operated by the University of Chicago. The Laboratory's mission is basic research and technology development to meet national goals in scientific leadership, energy technology, environmental quality, and national security.

Army Research Laboratory



The Army Research Laboratory (ARL) of the Army Materiel Command is the U.S. Army's corporate, or central, laboratory for materiel technology. ARL's mission is to execute fundamental and applied research to provide the Army the key technologies and analytical support necessary to assure supremacy in future land warfare.

Office of Research and Development of the U.S. Environmental Protection Agency



The Office of Research and Development (ORD) is the scientific and technological arm of the U.S. Environmental Protection Agency (EPA). ORD's mission is to:

- perform research and development to identify, understand and solve current and future environmental problems;
- provide responsive technical support to EPA's mission;
- integrate the work of ORD's scientific partners (other agencies, nations, private sector organizations, and academia); and
- provide leadership in addressing emerging environmental issues and in advancing the science and technology of risk assessment and risk management.

Goddard Space Flight Center



The Goddard Space Flight Center is NASA's Center of Excellence for Scientific Research. Goddard is charged with being pre-eminent within the Agency with respect to the human resources, facilities and other critical capabilities associated with scientific research. Goddard's mission is to expand knowledge of the Earth and its environment, the solar system and the universe through observations from space.

Merck Frosst Canada and Co.



Merck Frosst Canada and Co. is a large fully integrated pharmaceutical company. The Centre for Therapeutic Research located in Kirkland, Quebec is the largest privately owned biomedical research facility in the country. It has R&D programs aimed at discovering novel therapeutic agents for the treatment of allergic, respiratory and inflammatory diseases, and for diabetes, osteoporosis and neuronal injury.

The National Institute of Standards and Technology



The National Institute of Standards and Technology (NIST) is a non-regulatory federal agency within the U.S. Department of Commerce. NIST's mission is to strengthen the U.S. economy and improve the quality of life by working with industry to develop and apply technology, measurements and standards.

Nortel Networks



Nortel Networks is a Canadian-based global corporation with 70,000 employees in 150 countries worldwide. The corporation is committed to working with its customers and global partners to create a new era of high-performance networks that are changing the way the world communicates and shares ideas. As an industry leader in deploying Internet era technologies, the company invests US \$2.5 billion in research and development.

practices in other organizations in Canada and the U.S. Consequently, we used practices from outside the Canadian federal system to illustrate ways and means of moving in the directions laid out by the attributes. These practices were described to us as what each organization expected its managers and staff to do, not what always happened.

22.40 Our work suggests that the attributes are applicable to both private and public sector organizations. The

emphasis that is placed on any one attribute, and the practices that support progress toward an attribute, vary with the mandate and mission of the organization. This is particularly true for public sector organizations where mandates can cover a very broad array of responsibilities under the heading of public good.

22.41 In the remainder of the chapter, we describe each attribute, and provide examples of practices from organizations we visited.

People Focus

Management knows what research and other talent it needs to accomplish the mission, and recruits, develops and retains the right mix of people

22.42 Today's research organizations require highly competent, multi-skilled professionals. Researchers need to be first-rate scientists as well as be able to communicate with users and work in teams. Their technical competencies need to be aligned with the organization's current and anticipated needs. Research managers must also possess demonstrated technical competence as well as strong leadership and management skills. All of the organizations we visited commented on the importance of the right mix of people in achieving success. Management in several of these organizations invests significant time and effort in identifying core competencies, and in recruiting, managing, developing, motivating and retaining high-quality staff.

22.43 Management must decide on the core competencies that are needed to address current and evolving research priorities. The required core competencies are not only those needed to conduct high-quality research but also those needed to access and synthesize knowledge produced by others and use it effectively, to manage research performed internally and externally, and to integrate science into policy advice and standards/regulations development.

22.44 Merck Frosst views recruitment as a long-term investment in the future of the company. Consequently, its approach includes science literacy outreach activities in the elementary and high schools, a well-developed co-op university student program, and tracking of high potential students through graduate school. Merck Frosst treats recruiting as among the most important functions of management. If this is done well, everything else falls into place.

22.45 At Nortel Networks, we heard that hiring and retaining the best people are essential to maintaining its leadership position in a highly competitive environment. Nortel looks for a good balance of "mavericks" and team players.

22.46 At the Goddard Space Flight Center, the importance of building a complement of strong researchers was emphasized, particularly in view of the high degree of mobility of talented research staff today. Building a strong complement involves both recruiting "superstars" to spark creativity and innovation, and growing excellence from within by building on the enthusiasm and motivation of existing talent and their willingness to learn.

22.47 In 1997, the Alberta Research Council put in place a strategic hiring program as an investment in the future. It set aside \$1 million (3.5 percent of the salary and benefits budget) to increase its core competencies and develop new capabilities, as well as expand its business development and entrepreneurial expertise. It continues to use this program to recruit and maintain its core competencies.

22.48 Nortel Networks invests in the development of its research managers. Management recognizes that the skill set of a research manager differs from that of a researcher. Good research managers must not only understand the culture of research and have technical competence but also have well-developed leadership and management skills, people skills and communication skills.

22.49 The Army Research Laboratory (ARL), along with a number of other U.S. Defense Department laboratories, recently embarked on a new alternative personnel demonstration system designed to provide the ARL Director with increased flexibility to manage the work force. Changes had been called for in many studies of the Defense labs by external review panels over the years. Studies unanimously pointed to the inflexibilities

Management recruits, develops and retains the right mix of people.

of the U.S. civil service personnel system as limiting the labs from attaining their full potential as world-class research institutions. The new approach encompasses the following benefits: a compensation system consisting of broad bands that are more competitive with the private sector at the entry level, and within which employees can be moved with much greater flexibility; a pay-for-performance system enabling the appropriate rewarding of outstanding performance; a streamlined job classification system; enhanced training opportunities; and simplified discipline and separation procedures.

22.50 To maintain technical excellence and move employees through career levels as their skills and abilities permit, Argonne National Laboratory has adopted a career management system based on competencies for its scientific and engineering staff. The system allows individuals to measure their growth and plan for their professional development. The system is also used as the basis for the compensation program. Salaries are based on the requirements of the position and the outside job market, which determines the competitive salary range for similar positions in the research and development field. The United States Army Research Laboratory has the following perspective on the need to maintain in-house competencies. “If the Army is to be able to intelligently acquire the complex technological developments for tomorrow’s battlefield, it must have a cadre of people that understand both the technology and what the private sector is offering to deliver, and can then evaluate what is delivered to assure that it can do the job.”

22.51 We found that research organizations use alternative approaches to recruitment (for example, secondments and use of contractors), build bridges to future talent pools (for example, outreach activities with schools, colleges and

universities) and mechanisms to respond to shifts in core competency requirements (for example, transition assignments, retraining and outplacement).

22.52 Other examples of constructive initiatives that we found from our research and visits to organizations include:

- use of parallel career paths (research and management) with opportunities to move back and forth to develop new leaders with appropriate skills in both areas;
- continuous learning opportunities (exchanges, deployments, attendance at professional conferences, and opportunities to participate in international working groups);
- peer recognition and awards (publication in scientific journals, patents, membership on prestigious external committees and internal award programs);
- incentives for being creative and innovative (special fund for new initiatives or special projects to encourage the best to pursue promising new areas);
- training programs that are aimed at developing researchers’ non-technical skills such as communicating and collaborating with others; and
- strategies for identifying, attracting and developing the required talent, such as:
 - sponsoring university research to solidify linkages with universities;
 - engaging in collaborative research projects with universities to stay at the cutting edge;
 - coaching and mentoring of young researchers by more experienced researchers;
 - using career management planning to ensure appropriate progression; and

- putting in place succession plans and developmental programs to equip potential managers with the necessary skills to move into key positions.

Employees are passionate about their work, have confidence in management, and are proud of their organization

22.53 Employee morale lies at the heart of productivity and organizational success. Satisfied employees are creative, innovative, efficient and effective. Furthermore, they:

- trust management;
- are treated with respect and feel valued and relevant;
- have opportunities to learn, upgrade their knowledge and skills, and reach their full potential;
- appreciate and can deal with change, including the termination of a research project due to changing priorities or more attractive opportunities;
- are encouraged to contribute ideas and feel free to speak out on issues of concern without fear of retribution (trust and openness);
- are provided reasonably timely feedback on suggestions and requests;
- receive reasonable empathy concerning challenges that they face on and away from the job; and
- believe that their overall compensation and job-related benefits are fair and reasonable.

22.54 This attribute presumes a positive and supportive organizational culture. It assumes that there is a fit between the employees and the organization's mission, values and vision, and that employees are trustworthy, competent, have a sense of purpose and self-worth, and are team players. Employees who are passionate about their work treat their job as more

than "nine-to-five" and yet maintain balance with their non-work life.

22.55 Employees tend to be passionate about their work and proud of their organization if they feel that they are making contributions to the success of their organization, are recognized for their contributions and are empowered to achieve agreed results. This requires a work environment where the roles are reasonably clear, and teamwork and participative management are results-oriented. Ensuring conditions such as these requires proactive management. Use of organizational climate surveys can assist management in gauging the health of the work environment. For example, in 1996, the Environmental Protection Agency's (EPA) Office of Research and Development (ORD) launched a new Strategic Plan that introduced a number of significant changes to how ORD conducted its business. Through a series of workshops on managing change, staff identified issues in five areas for improvement: reduce red tape; communications; career advancement and development; resources and infrastructure; and integrate science with the EPA's mission (put science first). Exhibit 22.5 provides an overview of the lines of inquiry used in the organizational climate survey.

22.56 Prompt response by management to survey results is important to maintaining employee confidence. The Alberta Research Council (ARC) measures employee satisfaction and opinions with annual surveys. Survey results, including all employee comments, are reviewed by senior management for action and follow-up discussion with managers. Overall survey results are also shared with all employees at the annual all-employee meeting and are posted on an internal ARC Web site. ARC has set a goal to increase employee satisfaction from 67 percent in 1997.

22.57 Employee confidence in management and pride in the organization

Employee morale lies at the heart of productivity and organizational success.

are nurtured through transparency and openness. For example, Nortel Networks aims to achieve this by:

- establishing a climate of security — for instance, because the failure or termination of a project does not mean the end of a researcher's career, researchers feel secure in suggesting that a project be stopped without fear of losing their job;
- encouraging openness by sharing a reasonable level of information concerning company plans and strategies with employees; and
- delivering on promises or explaining why not.

22.58 Openness and transparency are particularly important in public sector research organizations charged with the provision of scientific advice as input to the development of policy and regulation. Openness stimulates greater critical discussion of the scientific basis of policy and regulatory proposals and brings to bear any conflicting scientific evidence that may have been overlooked. Because scientific advice often involves a range of opinion, it is important that the process

leading to a decision be transparent. Scientific evidence and analysis (other than proprietary information) underlying policy and regulatory decisions need to be widely disseminated and employees need to have a clear understanding of how the science was taken into account in the formulation of policy or regulation.

22.59 Other examples of constructive initiatives that we identified include:

- Managers are open and frank about the challenges facing the organization and strategies for dealing with them.
- Management seeks and acts on employee feedback in a timely manner.
- Senior management is visible and interacts with staff (for example, participates in celebrations, awards ceremonies, retirement parties).
- Management recognizes employee participation in activities that enhance the organization's reputation, fostering pride in the organization (outreach, science literacy, expert committees, and conferences).

Exhibit 22.5

Office of Research and Development: Organizational Climate Survey

The following are some of the factors being tracked by the Office of Research and Development through its annual organizational climate survey. The survey assesses the health of the work environment and management uses the results to make improvements.

- There is fair distribution of work among employees.
- There is a spirit of co-operation.
- Staff treat each other with respect.
- Staff trust management and management trusts staff.
- Superior performance is recognized and rewarded.
- Employees (staff and managers) are satisfied with their job.
- Employees have the resources needed to perform their job.
- Employees know what to do to achieve career goals.
- Employees are encouraged to pursue educational and training opportunities.
- Individual differences are respected.
- Employees are kept informed.
- Employees are asked for input to decisions.
- Managers address challenging situations competently.
- Management responds to employee feedback.
- Teams are empowered and superior performance is recognized and rewarded.

Source: U.S. Environmental Protection Agency

Leadership

The current and anticipated needs of dependent constituencies drive the organization and its research programs

22.60 Dependent constituencies are those individuals, groups or organizations who absolutely depend upon the research outputs of the organization to carry out their own responsibilities. Their effectiveness depends on the research support they receive. Determining current needs and anticipating future needs of dependent constituencies requires focussing on outcomes or end-results from their perspective. It requires the involvement of management and scientific staff from both the research organization and its constituencies as well as other knowledgeable persons. Being driven by dependent constituency needs implies a relentless alignment of organizational effort with those needs.

22.61 Because the very existence of an organization depends upon its ability to respond effectively to constituency needs, the clear definition of dependent constituency groups and their needs is important in order to channel efforts and resources into achieving what is relevant and important to these groups. For public sector research organizations, the government itself is a dependent constituency. The results of government research are increasingly inputs to the development of policy, regulations and standards.

22.62 Both government and private sector research organizations focus most of their effort on research aimed at achieving target outcomes or end-results; they direct some effort at "exploratory" research to identify yet unknown needs and opportunities (from their constituencies' perspectives) as well as to identify new and better approaches to addressing known needs.

22.63 Research planning involves assessing the scientific challenges

associated with achieving target outcomes, and determining the research thrusts and programs to address those challenges. It also involves assessing the requirement for exploratory research to better define issues, identifying the approaches to addressing the scientific issues, and aligning current research with agreed priorities. Some of the exploratory research should lead to the initiation of significant research programs.

22.64 As part of anticipating needs and opportunities, research organizations have mechanisms for identifying:

- end-use issues and trends as well as relevant and emerging scientific developments; and
- new constituencies who would benefit from the research organization's expertise and research findings.

22.65 The research needs generally far exceed the available resources, and hence priorities must be set. Priorities are best established through involvement of dependent constituencies, and with an understanding of the limits on the organization's capacity to deliver. The organization assesses the significance of the need or opportunity (for example, risk to and potential impact on health and/or the environment, potential for wealth creation, and importance of participation in an international activity), and the urgency to address the need or pursue the opportunity and the impact of not doing so. It also assesses the likelihood of success (considering the technical and non-technical challenges, the timing, and the availability of expertise and resources), the appropriateness of government involvement, the potential return on investment, and the potential for leveraging government resources.

Exhibit 22.6 describes the research planning and priority-setting process followed by the Environmental Protection Agency's Office of Research and Development.

The very existence of a research organization depends on its ability to meet constituency needs.

22.66 The participation of research staff in planning activities strengthens their understanding of constituency needs and promotes alignment of research activity with those needs. Their participation also alerts management to organizational policies and procedures that may need adjustment to support the achievement of research goals. At Merck Frosst, the research staff participate actively in determining the exploratory and requirement-driven research that responds best to the objectives established by corporate management.

22.67 The NASA Strategic Roadmap and Performance Plan are good examples of research plans that focus on outcomes, contain precise goals and performance expectations, and use plain language so that employees at all levels understand

how the research, overall and at the project level, addresses constituency needs. Exhibit 22.7 provides an extract from these documents that illustrates goals specific to the Goddard Space Flight Center.

22.68 Other examples of constructive initiatives that we found include the following:

- Research organizations engage dependent constituencies in reviewing past successes and failures, and identifying opportunities for improving the timeliness, usefulness and impact of the research organizations' input.
- Research organizations engage dependent constituencies in planning research programs and projects as well as

Exhibit 22.6

**Office of Research and Development:
Approach to Priority Setting**

The Environmental Protection Agency's (EPA) Office of Research and Development (ORD) uses a highly interactive approach to setting research priorities and plans. ORD seeks input from all parts of the EPA, from state and local governments, the EPA's Science Advisory Board (external advisors), the U.S. National Research Council, and the private sector. The pool of potential topics is divided into two categories:

- those that are mandated by statutory requirement or court order (little if any discretion); and
- all other topics.

The pool of all other topics is narrowed by retaining only those that are within ORD's mission and goals. ORD then applies a series of human health, ecological health and risk management criteria to rank the mission-related topics according to their potential to support effective risk-reduction — one of ORD's strategic principles. High-priority research topics are translated into research strategies and plans by teams composed of ORD scientists and engineers and representatives from EPA programs and regional offices. Plans state the rationale for and intended products of the research to ensure that the results will be communicated to clients and stakeholders and to facilitate the tracking of progress towards goals. Research plans are subjected to rigorous external peer review. Finally, ORD determines whether the research will be done internally at ORD or externally through grants to universities, through a partnership agreement with other departments or through a contract, by considering the following questions:

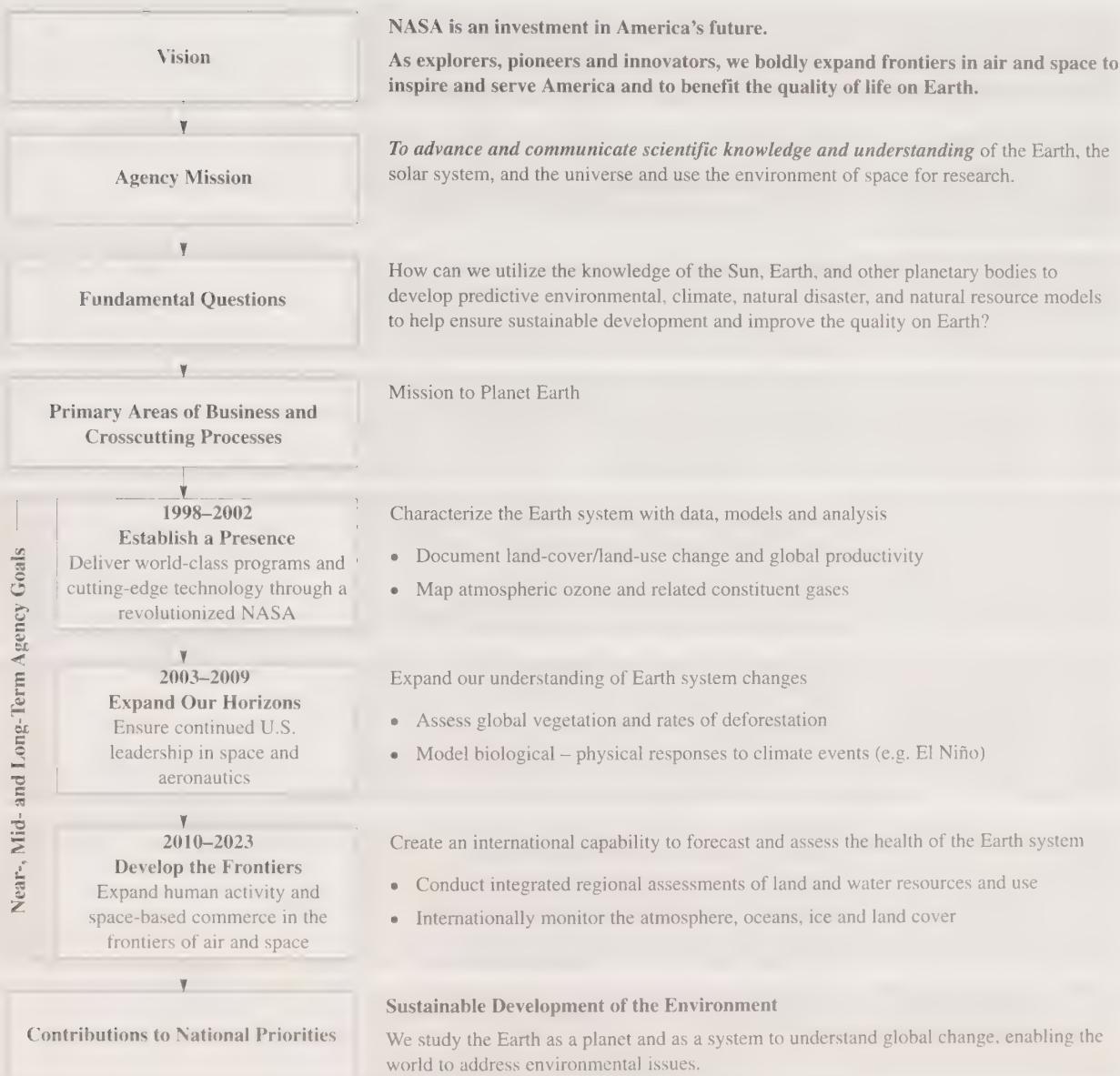
- Which organization has the most appropriate expertise?
- What type of work is called for (risk assessment and regulatory support work are retained in-house, whereas research, including assessment methods research work, may be done externally)?
- How urgently are the research products needed?
- Is there value in involving multiple institutions?
- To what extent can ORD specify what is needed (contracts)? To what extent must ORD rely on the creativity and insight of the researcher (grants)?
- What is the availability of in-house capacity?
- What opportunities are there for leveraging?

Source: U.S. Environmental Protection Agency, 1997 Update to ORD Strategic Plan
<http://www.epa.gov/ORD/WebPubls/stratplan/>

Exhibit 22.7

Excerpt From NASA's Strategic Management System Roadmap

Vision, Mission, Questions, Roadmap and Goals, and Contributions to National Priorities

**Note:** The excerpt focusses on aspects most relevant to the Goddard Space Flight Center.

The complete roadmap can be found at the Web site shown below.

Source: NASA Strategic Plan<http://www.hq.nasa.gov/office/codez/plans/NSP99.pdf>

Without buy-in from employees and dependent constituencies, management's vision, values and goals are little more than a dream.

reviewing progress and making the necessary adjustments to plans.

Employees and dependent constituencies share management's vision, values and goals

22.69 This attribute presupposes that the organization's senior managers provide leadership to develop a vision supported by values, goals and strategies, and communicate them to employees and dependent constituencies. Without buy-in from employees and dependent constituencies, management's vision, values and goals are little more than a dream.

22.70 It is easier to point to people who were or are leaders than to describe leadership. Nevertheless, by describing leadership from a number of angles, a clearer picture emerges.

- Leadership functions include creating and promoting values and expectations, setting directions (the vision), projecting a strong constituency (client/stakeholder) focus, aligning the systems, policies and resources with the vision and mission, and empowering employees to be productive.

- Leadership in a research environment recognizes that researchers are highly trained professionals who are guided in what they do by the standards, expectations and structures provided by the research disciplines in which they work. Leadership is less about directing and controlling, and more about establishing and promoting a shared vision and shared values, establishing a pathway and harnessing the organization's talent and resources to achieve the vision, supporting research professionals by creating and maintaining a positive research environment, and building relationships with dependent constituencies (those individuals, groups or organizations that depend upon the organization's work).

- Leadership provides the conditions under which researchers can exercise creativity. Leaders model the values they espouse, such as respect for individuals, trust, integrity, honesty, openness, transparency and a reasonable work/life balance. They remove roadblocks that hinder performance and adopt organizational policies that support the research environment (for example, policies on intellectual property management, scientific publication, and attendance at conferences).

- Leaders serve as examples and sources of inspiration. A leader's actions say more about what he or she values than do slogans and pep talks. Integrity and trust are established when a leader's actions are in harmony with personal and organizational values. Senior executives' behaviour and actions shape the environment within the organization and its relations with collaborators and dependent constituencies. Their actions, in particular, influence the behaviour of managers, teamwork among scientists and staff, and the sharing of knowledge and learning — conditions that are essential for creativity and innovation in a research organization.

22.71 Several of the research organizations we visited emphasize the need for leadership and for ensuring that employees align their effort and support with the mission, values and goals of the organization.

- Merck Frosst believes that skilled leaders are needed at all levels to enable the organization to deal with complexity, to have a productive work environment and to recognize the importance of a work/life balance. Consequently, leadership skills training is being provided to all employees, not just senior executives. The implementation of leadership principles is reinforced by including leadership in the performance management system.

- The Environmental Protection Agency's Office of Research and Development is conducting an exercise with input from staff at all levels to describe its purposes, values and envisioned future. This is the first step in the development of its Strategic Plan 2000. The objective of seeking employees' input is a step to achieving their buy-in to the Strategic Plan.

- The U.S. Army Research Lab (ARL) uses a "planning thread" concept to help ensure that the research activities of its scientists are aligned with the organization's mission and vision. ARL's Strategic Plan describes the ARL mission and vision and lays out the Army requirements and needs in the short, medium and long terms. For each of ARL's primary mission areas, a statement of strategic intent is followed by several long-term goals, each associated with a desired outcome. From these, a series of short-term technical goals are expressed in the annual performance plans. By following the planning thread, a researcher can see where his/her work connects to the overall mission of ARL and to the Army.

- At NASA's Goddard Space Flight Center (GSFC), managers meet with their employees to discuss how their individual performance contributes to the achievement of NASA's Performance Plan and GSFC's Performance Plan. Exhibit 22.8 provides an example of the tool used to summarize this discussion.

22.72 It is also important that dependent constituencies share the organization's mission, values and goals, particularly since the many of the intended impacts of research organizations take years to materialize. The 1996 S&T Strategy recognized this and required science-based departments and agencies to have external advisory bodies. Federal research organizations whose dependent constituencies share the research organization's mission, values and goals

have effective relations with all levels of management and staff within their respective dependent constituent organizations.

The portfolio of programs represents the right research, at the right time and at the right investment

22.73 This attribute is about getting the best value for money, taking into account that most research organizations serve a hierarchy of dependent constituencies (for example, Parliament, Cabinet, the responsible minister, departmental senior management). "Portfolio" refers to a suite of research programs, or groups of relatively homogeneous or highly inter-related research projects. "Right research at the right level of investment" means selecting research based on a set of criteria.

22.74 The following are examples of criteria that can be used to manage research portfolios:

- importance to the dependent constituencies;
- fit with the organization's mission, goals and overall priorities;
- need for involvement (for example, no one else is doing it, cannot rely on other research performers);
- benefit-cost considerations (for example, significance of the opportunity/problem, urgency, potential impact if successful, required level of investment);
- likelihood of success (based on technical considerations, timeliness, required versus available expertise, affordability); and
- overall balance within the portfolio (for example, mission-oriented versus relevant exploratory research, short-versus longer-term target impacts, level of risk, support among various dependent constituencies).

The portfolio needs to represent the right research at the right time and investment.

Exhibit 22.8

Goddard Space Flight Center Employee Performance Communication System – Linking the Employee to the Agency Strategic Plan

Managers at the Goddard Space Flight Center (GSFC) meet with their employees to discuss how individual performance plans link to the various agency plans. The form shown below provides an outline for the discussion and a record of conclusions.



Enterprise
Strategic Plans



GSFC EMPLOYEE PERFORMANCE COMMUNICATION SYSTEM
LINKING THE EMPLOYEE TO THE AGENCY STRATEGIC PLAN

Employee Name _____
For Employee's Performance Period from _____ to _____

Key OBJECTIVE from the fiscal year 1999 NASA Performance Plan OR
GOALS from the NASA Strategic Plan:

KEY PERFORMANCE TARGET from the FY1999 GSFC Performance Plan OR
GOAL from the GSFC Strategic Implementation Plan:

KEY JOB ELEMENT from the Employee's Performance Plan that links to
the above:

The employee and supervisor should discuss the link between the employee's job
responsibility and the NASA Strategic Plan or NASA Annual Performance Plan,
including as appropriate an intervening link to the Center's plans. The supervisor will
provide a copy of this completed summary to the employee.

Supervisor's Signature and Date of Discussion

GSFC FY99
Performance
Plan

Organizational
Performance
Plans

Employee
Performance
Plans

Source: NASA Office of Policy and Plans
<http://www.hq.nasa.gov/office/codez/plans.html>

NASA Performance Management and Awards
<http://ohr.gsfc.nasa.gov/awards/awrddesc.htm>

22.75 Achieving and maintaining the optimum portfolio requires multiple lines of input, review and challenge, including:

- independent evaluations of programs;
- maintaining a lookout for attractive new opportunities; and
- management-driven reviews of portfolios that assess the performance of current programs and compare existing with potential new programs, and that result in identifying and making the necessary changes.

22.76 Nortel Networks conducts portfolio reviews on a quarterly basis. These are high-level reviews to verify that research groups are working on what the company needs, to review risks and risk management strategies and to address emerging problems that require senior management input to resolve.

22.77 The National Institute of Standards and Technology (NIST), for example, contracted the U.S. National Research Council Board of Assessment to assess the technical quality of the Measurement and Standards Laboratories. The focus of the assessment was on:

- the technical merit of the laboratory programs relative to the current state-of-the-art worldwide;
- the effectiveness with which the laboratory programs are carried out and the results disseminated;
- the degree to which the laboratory programs are meeting the needs for which they are intended; and
- the adequacy of the laboratories' facilities, equipment and human resources insofar as they affect the quality of the technical programs.

The findings and recommendations were published in an annual report and fed into NIST's annual planning and program management. NIST's response to these

recommendations appears in review panel reports for subsequent years.

22.78 Some U.S. government laboratories are operated by a contractor. The agreement with the contractor requires the use of an independent review process. For example, the University of Chicago manages the Department of Energy's Argonne National Laboratory. A board of governors provides guidance, oversight, direction and advice to the Laboratory management. Program oversight is carried out through a Science and Technology Advisory Committee that oversees the independent review process. The review committee assesses the quality of the staff and its performance during the year, the quality and timeliness of the programs and, to the extent that members feel appropriate, the relevance of the work to the long-range goals of the Laboratory and the missions of sponsoring agencies.

22.79 The Environmental Protection Agency (EPA) uses annual research program reviews, jointly organized by the Office of Research and Development (ORD) Research Co-ordination Teams and EPA's Program and Regional Offices, to present to EPA senior managers the entire ORD research portfolio in a given area. These joint reviews focus on the status and accomplishments of the ORD research program to ensure that ORD's research continues to meet its own and client objectives. The reviews also present selected ongoing research conducted by the program offices and regions so that the complementary research can be viewed. These reviews complement external peer reviews of ORD laboratories.

22.80 Other examples of constructive initiatives that we found include the following:

- Dependent constituencies are collectively asked to provide comments on existing or proposed portfolios to develop acceptance of the level of effort devoted to the various constituencies.

- Results from traditional scientific peer reviews are used as input to portfolio reviews (for example, to assess progress and likelihood of technical success).
- Research organizations undertake structured reviews of their portfolios, whereby programs are compared based on criteria that reflect their vision, goals and overall strategies and priorities.

Research Management

Research projects embody excellent science, involve the right people, are on track and within budget

**Excellent science
should be the basis for
all the work.**

22.81 The focus is on doing the right research projects and doing research projects right. This is important since projects are the core business of research organizations. Once the projects have been determined, excellent science should be the basis for all the work.

22.82 This attribute includes:

- ensuring that the project produces and is based upon excellent science and technology and that it stands up to the scrutiny of world-class experts;
- involving the appropriate and best available persons in the planning, conduct, technology transfer and review of projects (recognizing that different persons are likely to be involved at different times in the life of a project);
- periodically reviewing projects using increasingly demanding assessment criteria over time (referred to as stage-gating). These reviews normally include assessments from both a technical perspective and the dependent constituent's perspective;
- ensuring that research equipment and facilities are appropriate to the nature and requirements of the projects;
- ensuring that the research results are communicated and/or transferred to all relevant constituencies. This usually

requires the involvement of team members beyond the completion of the research; and

- managing the project, including the timetable and the budget, on a continuing and active basis to reflect the dynamics of the research environment.

22.83 Organizations that we visited apply vigilant project planning and management practices:

- Nortel Networks uses a project plan framework to monitor both fundamental and applied research projects and development projects. The framework includes the following elements: project scope, description of tasks, key assumptions, criteria for success, resources, milestones (stop/go gates), risks and contingencies. Information on these elements ensures that resources (human, equipment, financial) remain focussed on priorities and are well co-ordinated, and that a proper balance of reporting and activity is maintained.

• The type of expert review used to assess research projects varies with the nature of the research. Projects that are more short-term and developmental, with more predictable results, are best suited to reviews with quantifiable metrics (results-oriented milestones and performance expectations derived from the business plan). Projects of a more long-term and fundamental nature, with more unpredictable results, are best reviewed through peer review of quality and leadership. Even projects involving proprietary information are subjected to expert review. In these cases, procedures are modified to maintain confidentiality. For example, Merck Frosst calls upon scientists from other parts of the global Merck family of companies to undertake peer review while protecting commercial confidentiality.

- The Alberta Research Council recently adopted a stage-gating process with well-defined decision-making criteria, based on technological and

market considerations, to better manage research projects from the idea stage to the commercialization stage. ARC has developed a formal decision-making grid, using a proprietary tool, to ensure due diligence in its investment decisions. The factors comprising the grid include technical advance, technical capability of the team, project management, strategic fit, market size, market accessibility, partner capabilities, probability of success, intellectual property position, return on investment to ARC, and impact on Alberta. For proposals in the early stage, the review is usually done within the business unit; however, as the project moves toward development and commercialization, external reviewers are involved.

- Researchers at Merck Frosst meet weekly to review the progress of major projects. When a project is not meeting expectations, managers take appropriate action and move staff resources to higher-priority projects. They encourage researchers themselves to recognize when a project should be abandoned, rather than imposing a top-down decision. In other words, it is recognized that results that do not meet expectations are a normal output of a risky activity such as research, and do not constitute a personal failure. Such findings may in fact lead to very useful insights even if they do not move the project toward the expected results. In this respect, some low-level activity may continue even if the project is no longer of priority, which serves to keep options open.

22.84 Other examples of constructive initiatives include the following:

- Proposals are solicited from within the organization to identify attractive projects that should be funded, and that might otherwise not be.
- Plans for deployment of the research findings are included in project plans. Furthermore, the knowledge transfer process begins at the project planning stage by involving dependent constituents.

Research projects leverage external resources

22.85 Leveraging external resources involves collaborating with research performers and dependent constituencies, as well as relying on and/or building on the findings of other research groups. External simply means outside the specific unit/division carrying out research. It includes interactions with staff in other parts of an organization. Leveraging is important since no research organization has all the required expertise and resources to identify and meet the needs of its dependent constituencies. Furthermore, involvement of dependent constituencies is a way of accelerating the adoption process and increasing the likelihood of success.

22.86 Research problems are becoming increasingly complex. Expertise from several disciplines and organizations is frequently required to effectively address the issues. As a result, private and public sector research organizations are increasingly turning to collaboration and partnerships to leverage their own expertise and resources. In government, issues are increasingly cutting across departmental boundaries (for example, climate change). Leveraging increases the likelihood of achieving objectives by optimizing the impact of available human and financial resources and bringing to bear the best expertise from a variety of sources. It also helps focus the research organization on the target end-result and expedites the technology transfer process.

22.87 The U.S. Army Research Laboratory's Federated Laboratory (FedLab) initiative (see Exhibit 22.9) demonstrates a number of the dimensions of this attribute. These include a novel delivery arrangement that focusses on ARL's strengths and brings in complementary expertise from other partners to achieve the Army's goals; use of a competitive approach to finalize a suite of highly innovative projects that address an identified need (project

No research organization has all the required expertise and resources to identify and meet the needs of its dependent constituencies.

proposals are subjected to a competitive selection process involving external peer review); and the involvement of external partners in project monitoring and reporting processes.

22.88 Scientists and engineers of the Environmental Protection Agency's Office of Research and Development contribute to every stage of EPA's risk assessment and management process. This develops and maintains effective relationships between researchers and program and regional staff. The research staff not only identify and characterize environmental problems (risk assessment) but also help other parts of EPA to find and implement efficient, cost-effective solutions to the problems. They are involved in identifying risk management options, evaluating their performance, cost and

effectiveness, and monitoring improvements.

22.89 Other examples of constructive initiatives include the following:

- Leverage is used as one of the criteria in selecting and comparing both projects and programs.
- Graduate students at universities are provided funding to undertake exploratory research in areas of interest to the research organization and its dependent constituencies.

Organizational knowledge is systematically captured and turned into needed work tools

22.90 This attribute entails proactively creating organizational knowledge and then exploiting it by making it accessible to all staff for continuous learning and to

Exhibit 22.9

**Army Research Laboratory:
The Federated Laboratory**

The Army Research Laboratory (ARL) adopted a new concept of operations to deal with the challenge of responding to a new mission assignment at the same time as resources were being reduced.

The new assignment required technical capabilities for which ARL did not have the necessary expertise. ARL recognized that the private sector possessed strong expertise that ARL could leverage. As a result, ARL developed a new approach to partnering with the leaders of relevant private sector efforts. The approach, called Federated Laboratory (FedLab), allows ARL to jointly plan and execute technical programs, jointly evaluate, assess and report on the work accomplished, and redirect the work as necessary. FedLab involves a collection of geographically distributed "virtual" laboratory divisions, augmenting the capabilities of ARL. Under ARL leadership, programs in the private sector are integrated with those already existing within ARL. Funding is provided by the government — it is not a cost-sharing arrangement.

Technology areas were defined, consortia were selected (involving at least one industry partner as consortium lead, one major research university partner and one historically Black college or university or minority institution) through a competitive peer-reviewed process, consortia activities are directed by a Consortium Management Committee formed by senior representatives of all partners and chaired by a senior ARL technical manager.

To enhance technology transfer between ARL and the partners, there is a requirement for long-term technical staff rotations between ARL and the partners.

The approach does more than bring together the best of the private and public sectors. It responds to other demands being placed on ARL: to increase outsourcing, to find dual-use solutions, and to use commercial standards and products.

FedLab has an important leveraging effect: ARL's science and engineering staff is enhanced through working relationships with the best of the private sector (including staff exchanges); FedLab takes advantage of the best existing state-of-the-art facilities and encourages the construction of new industry facilities; commercial technologies are adopted and adapted to the military environment; and ARL is building an in-depth knowledge base and technical competence despite resource reductions.

Source: Army Research Laboratory

provide value to current and prospective dependent constituencies. Work tools such as new methods, management practices or technology resulting from organizational learning are needed to exploit knowledge.

22.91 Knowledge is the key asset of a research organization. Organizational knowledge encompasses personal and collective knowledge (know-how, expertise, experience and wisdom). Management of organizational knowledge, sometimes also referred to as intellectual capital, pulls together the knowledge that is dispersed throughout the organization, making it accessible and usable by others inside the organization and by its dependent constituencies. It involves the continuous recycling and creative use of shared knowledge and experience. It promotes continuous learning on an organization-wide level by ensuring effective use of existing knowledge, and sharing of new knowledge and lessons learned from past experience. Management of organizational knowledge ensures that competence remains with the organization even when individuals leave.

22.92 There are two key facets to the development and effective management of organizational knowledge. The first is processes to capture and tend the knowledge, to make it available to others, and to keep track of who is contributing to it and who is using it. The second facet is an organizational culture that values the sharing of knowledge.

22.93 There are natural barriers to the sharing of knowledge that result from rigid organizational structures, dispersed locations, turnover of staff, specialization within disciplines, and the “not-invented-here” syndrome. Leadership and the alignment of policy, incentives and performance measurement with the right organizational values can help overcome barriers.

22.94 The nurturing of “communities of practice”—informal networks of

individuals with common interests who come together spontaneously and choose to communicate across the rigid organizational structures — promotes organizational learning. They do this by improving understanding of concepts; increasing awareness of techniques available inside the organization or elsewhere; facilitating learning and sharing of experience; providing a forum for the peer review of ideas, theories and interpretation of data; and enhancing technology transfer. Management can support communities of practice through the provision of resources to facilitate activities.

22.95 Nortel Networks recognizes the value of networking for organizational learning. Among the methods used to promote the sharing of knowledge and experience are social events, co-location of project staff, informal coffee groups, formal events to discuss issues, and widely disseminated formal reports on activities. Nortel managers identified networking on a global basis as a more difficult challenge. Quarterly get-togethers and videoconferencing are techniques being used to address this challenge.

22.96 To better capture and share knowledge among scientific and technical staff on an organization-wide basis, the Goddard Space Flight Center is implementing the ISO 9001 standard. Processes, procedures and the know-how developed by individuals are being documented in accordance with the requirements of the standard. While ISO 9000 standards and guidelines are generally associated with organizations in the manufacturing sector, NASA is leading the way in the application of the standards to an R&D organization.

22.97 Other examples of constructive initiatives include the following:

- Policies, incentives and performance metrics are aligned to reinforce collaboration and knowledge sharing.

Knowledge is the key asset of a research organization.

**Well-managed
research organizations
are known to and
respected by leaders
within and outside
their respective
scientific communities.**

- All levels of management emphasize and practice developing trust and collaboration among organizational units, focussing on win-win outcomes.

Organizational Performance

The organization is widely known and respected

22.98 This attribute relates to the breadth and depth of the organization's reputation. Well-managed research organizations are known to and respected by leaders within and outside their respective scientific communities.

22.99 An organization commands respect when knowledgeable observers (individuals in the same or complementary areas who are not necessarily among the organization's constituencies, such as world-class researchers in other countries) judge that its science output is of high quality and at the leading-edge. Respect results from an organization's ability to maintain its reputation for excellence over a long period of time and to have its research staff sought after as participants in collaborative activities and partnerships and as members of prestigious committees. The participation of a significant fraction of the organization's research staff on international committees charged with the development of international standards and regulatory regimes provides an indication of the organization's credibility and reputation. For example, the National Institute of Standards and Technology (NIST) tracks staff participation in and chairmanships of standards committees and international committees.

22.100 An organization is also respected when dependent constituencies believe that it is performing an essential service, is accessible and responsive to their needs, is reliable, demonstrates flexibility, and is service-oriented. Government policy makers and regulatory bodies depend

upon public sector research organizations for high-quality scientific advice in the development of policies and regulations intended to protect the public good. To assure decision makers that advice is based on current and sound science, public sector research organizations are adopting a number of principles: early identification of issues requiring science advice; broad consultation on issues with experts in many disciplines and sectors; use of due diligence procedures to assure quality and reliability of the science; recognition of the limitations and risks resulting from scientific uncertainty; transparency and openness through the broad dissemination and publication of scientific evidence and analysis underlying policy/regulation; and periodic review of decisions in light of new advances in science.

22.101 We found that research organizations take steps to track their reputation:

- The Alberta Research Council monitors customer satisfaction annually by surveying how well its services meet customer requirements, and how important the services are to the customer. The survey helps management set improvement targets.
- The U.S. Army Research Laboratory also uses customer feedback to ensure quality, relevance and timeliness. ARL is exploring going beyond customer satisfaction to "customer value" — that is, "capturing the hearts of customers to the point that they will not only be satisfied when they receive your product, but they will go out of their way, and even sacrifice time, money or convenience, to come back to you the next time." Through a customer value survey, ARL identified "communication with the customers" as the attribute most valued by customers. Communicating with the customers includes talking and listening to them, visiting them, keeping them informed, and involving them in planning processes.

- Argonne National Laboratory values the confidence and support of its customers, stakeholders, neighbours and employees. Argonne uses many communication and outreach activities to enhance its reputation, visibility and image (science and technology publications, participation in technical conferences and workshops, public affairs, education and industrial technology programs). To enhance community relations, Argonne established a Community Leaders Roundtable that involves over 30 community leaders from towns, homeowner associations, governments, businesses and public-interest groups. The Roundtable provides a forum for ongoing dialogues about the Laboratory's activities, the expected impacts on the surrounding area and any community concerns.

22.102 Other examples of constructive initiatives that we found include the following:

- Feedback on the organization's credibility and reputation is obtained from experts, such as internationally renowned scientists, industry analysts, environmentalists and consumer groups.
- Feedback from surveys and expert reviews is shared with employees and advisory boards, with a view to identifying ways to improve organizational performance.
- Research staff is encouraged to accept invitations for membership of expert committees, to participate in external peer reviews, and to undertake collaborative research.

The organization meets the needs of its dependent constituencies

22.103 This attribute is achieved by providing dependent constituencies with expertise and research findings that are relevant, timely, significant and of high quality, and ensuring that the research findings are understood by the

organization's constituencies. This attribute represents the research organization's *raison d'être*, and the ultimate test of the quality of its management. Pursuit of all the previous attributes contributes to the achievement of this final attribute. It is important to be well-respected, but satisfying the needs of those who depend on the organization defines success.

22.104 To ensure and demonstrate the achievement of this attribute, research organizations take measures to promote understanding of research findings by constituencies, and assess the relevance, timeliness and significance of their research for the purpose of identifying opportunities for improvement.

22.105 Networking and personnel exchanges with constituencies are among the best ways to promote effective communication and understanding of results. Providing opportunities for people to exchange ideas is more effective than simply publishing results in various outlets. Such opportunities include researchers talking to other researchers, users interacting with researchers, policy and regulatory staff interacting with research staff, scientists participating on national and international standards-setting committees. NASA has set an agency-wide objective "to improve the external constituent communities' knowledge, understanding, and use of the results and opportunities associated with NASA's programs." The Goddard Space Flight Center has set specific performance goals to contribute to the agency-wide objective:

- Increase the number of visiting scientists, resident research associates, graduate students participating in Goddard programs by more than 10 percent over the 1998 fiscal year level.
- Increase by five percent the number of science research co-op agreements with universities, including predominantly minority universities.

It is important to be well-respected, but satisfying the needs of those who depend on the organization defines success.

- Enhance the quality of knowledge communicated to the public and to the media by involving principal investigators and project managers in all mission-related media activities.
- Establish collaboratively, with the web-based managers in the technical community, guidelines for enhancing public access to web-based information.

22.106 Involving potential users and receptors in the identification and definition of research projects and, where feasible, in the conduct and management of the research project also enhances the dissemination and eventual use of results. The Army Research Laboratory's FedLab initiative (see paragraph 22.87) illustrates a number of practices that support the effective dissemination of results:

- Partners are involved in planning, conducting and managing research projects through a Consortium Management Committee.
- Personnel exchanges among partners are required as part of the consortium agreement.
- An annual technical symposium involving all participants is held to present results, and discuss with receptors.

22.107 With respect to assessing the relevance, timeliness and quality of the research, the Committee on Science, Engineering and Public Policy of the U.S. National Academy of Science, the National Academy of Engineering and the Institute of Medicine recently stated that

expert review is the most effective means of evaluating federally funded research programs, both basic and applied. Expert review can include quality or peer review by independent experts, relevance review by potential users and experts in related fields, and benchmarking to assess the international standing of the research. We visited two organizations that apply this approach:

- The U.S. Army Research Laboratory's Performance Evaluation Construct recognizes the complexity of assessing the performance of a research organization that conducts a broad range of activity from exploratory to requirements-driven work. The Construct covers three principal areas of interest: relevance (does the work respond to customer requirements?); productivity (are we progressing toward goals at an acceptable rate?); and quality (are we doing world-class work?). It is built on three pillars: peer review, metrics and customer evaluation (see Exhibit 22.10). ARL discourages the use of formulas to calculate performance scores, preferring to use a more qualitative approach. The approach is sufficiently flexible to provide information to senior management, which can be integrated and used in a variety of ways; these include forming part of the performance standards of ARL's senior leaders, thus coupling performance to reward.

22.108 Exhibit 22.11 demonstrates how EPA's Office of R&D monitors its success in meeting constituency needs.

Exhibit 22.10

Relationship of Three Pillars of Army Research Laboratory Performance Evaluation Construct to Principal Areas of Interest

Pillars (Method)	Goal		
	Relevance	Productivity	Quality
Peer Review	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Metrics	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Customer Evaluation	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>

Source: The ARL Performance Evaluation Construct
<http://w3.arl.mil/mgtinit/mgtpec.html>

Very useful Somewhat useful Less useful

22.109 Other examples of constructive initiatives that we identified include the following:

- An evaluation framework is developed at the time that a program is launched, including the identification of measures and targets that will be used to evaluate the program at a later date.
- Research organizations are increasingly relying on ongoing and periodic reviews of projects and programs

to ensure progress toward providing relevant, timely and significant expertise and research findings to its dependent constituencies.

Conclusion

22.110 The organizations we worked with as part of the study indicated that the attributes we have identified describe the outcomes that they are trying to achieve through good management practice. Some attributes may be more important than

"In general, the success of a research organization can be measured in several ways: by the number of articles published in prestigious scientific journals, by the number of times that articles written by the organization's scientists are cited in other journals, and so on. However, for a mission-oriented organization like the Office of Research and Development (ORD), measures of the extent that we help and support the Environmental Protection Agency (EPA) in meeting its goals are equally crucial. In measuring the success of this Strategic Plan, the quality of ORD's work, and the usefulness of our research products, we will use the following measures of success.

Significance: Is ORD working on the right issues?

This is a measure that the EPA Program Offices and Regions and the broad scientific community can help us judge. For our research, development and support efforts to be useful, we must work on the most important environmental issues and target areas for research that will significantly improve risk assessment and/or risk management in the Agency and elsewhere. Peer review by scientists in the external scientific community will assist us in judging significance.

Relevance: Is ORD providing data that the agency can use?

This question can best be answered by the rest of the Agency and is best judged by the degree to which contributions support EPA decisions. ORD will strive to ensure that its work is useful to the Agency and has a positive impact on advancing EPA's mission. ORD's new information management plan seeks to ensure that we make our stakeholders aware of and able to access ORD's science data and information products.

Credibility: Is ORD doing research of the highest quality?

ORD's credibility can best be judged by the external scientific community through such mechanisms as peer review of ORD products, reviews of programs at the ORD laboratories, peer-reviewed journal articles, scientific citations, and external recognition of both ORD and its people. Further, we will be judged by the external scientific community on the extent to which we advance the state of environmental science.

Timeliness: Is ORD meeting EPA's expert consultation and assessment needs in a timely manner, providing research products according to schedule, and addressing long-term issues with adequate forethought and preparation?

The first part of this question can best be answered by EPA's Program Offices and Regions as they determine whether ORD consultations and assessments are being provided in time to be optimally useful for Agency decisions. The middle part of this question can be answered by ORD managers and EPA's Program Offices and Regions through annual program reviews and other activities. The final aspect of timeliness is more subjective and therefore more difficult to assess. ORD has accepted the challenge of anticipating important environmental issues that are just emerging and may not become critical problems until well into the next century. The U.S. public is the ultimate judge of how successful ORD has been in this effort. ORD will strive to regularly gather the public's view on this issue."

Exhibit 22.11

Office of Research and Development: Measures of Success

Source: U.S. Environmental Protection Agency, 1997
Update to ORD Strategic Plan
<http://www.epa.gov/ORD/WebPubs/stratplan>

We believe the attributes are telling indications of how well a research organization is managed.

others to particular organizations, depending upon an organization's role, environment and stage of development. The extent to which an organization successfully adopts practices appropriate to its situation will affect its ability to achieve overall success. We believe that these attributes are telling indications of how well a research organization is being managed.

22.111 Our intention in doing this work was to inform Parliament about attributes of well-managed research organizations

and provide guidance to federal research managers. We expect that the attributes presented here will be further refined over time as researchers, research managers, evaluation specialists and auditors discuss and use them. We hope that our work will catalyze further development of these attributes. We invite others to build on our work by developing more specific performance measures and by defining ranges of performance levels for each attribute so that organizations can monitor improvement in their performance.



About the Study

Objectives

The objectives of our study were:

- to inform Parliament about attributes of well-managed research organizations that can be used to assess the management of research activities in federal departments and agencies; and
- to provide guidance to federal research managers on ideal outcomes of good management together with examples of practices followed by respected research organizations outside the federal system to achieve the performance ideals described by the attributes.

Scope

Through the study we developed a set of attributes capturing the ideal outcomes of good research management. The attributes embody the operating principles enunciated in the government's 1996 S&T Strategy, the ingredients of the Human Resources Framework, which supports the Strategy, and operational guidance gleaned from a review of the research management literature and other publications (a list of key references is available upon request). The attributes were refined through discussions with research managers in Canada and in the U.S. and visits to a number of research organizations. The visits were also used to obtain examples of practices that support the attributes.

The organizations we visited were drawn from the public and private sectors and from important sectors of the economy. They represent the range of government research activities (knowledge creation; wealth creation; policy, regulatory and security functions; and the provision of major research infrastructure).

Study Team

Assistant Auditor General: Richard Flageole

Principal: Peter Simeoni

Director: Marilyn Taylor

For information, please contact Peter Simeoni.

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This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



Chapter 23

Involving Others in Governing

Accountability at Risk

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Involving Others in Governing

Accountability at Risk

Main Points

23.1 We found a total of 77 new governance arrangements across the federal government, involving annual expenditures totalling over \$5 billion. Federal investments in some arrangements are quite small, such as the Canadian Industry Program for Energy Conservation, but others involve federal commitments of billions of dollars, such as the Canada Infrastructure Works Program.

23.2 Under these arrangements, the federal government involves external partners in the planning, design and achievement of federal objectives, replacing delivery by federal employees, contractors or agents. These partners are not accountable to ministers and Parliament.

23.3 These initiatives, if properly implemented, have the potential to improve the delivery of federal programs and services. However, many of the new governance arrangements we examined have been put together in an ad hoc manner that puts accountability to Parliament at unnecessary risk. Parliament has limited means under these arrangements — in some cases no means — of holding the government to account for the federal functions performed or the federal objectives to be achieved. Good will and trust alone, while essential in all arrangements, are not adequate insurance for continued success in the long term.

23.4 For these new arrangements, the government does not have in place a consistent and generally accepted governing framework that safeguards the essential principles of our parliamentary system. Nor has it been adequately capturing and communicating the lessons being learned in these new approaches. In our view, the federal government remains accountable to Parliament for the use of federal tax dollars, assets and authorities, no matter what tools it uses or arrangements it puts in place with partners to achieve its public objectives.

23.5 Parliament and the public need to be consulted on the development of an adequate governing framework that will reconcile new governance arrangements with accountability to Parliament for the exercise of federal functions by parties outside the federal government.

Background and other observations

23.6 Over the last decade, the government has significantly increased its use of external partners in innovative arrangements to deliver federal programs and services to Canadians. In some cases, these arrangements have diffused federal power, by drawing outside parties into the process of actually governing Canadians in important areas of public policy that were once the sole domain of the federal government.

23.7 The new governance arrangements we examined use a wide variety of approaches to program and service delivery. Provision for ensuring good governance and accountability to Parliament and the public is very patchy: we found limited reporting of performance, many weak accountability mechanisms, and inadequate attention to transparency and protection of the public interest. These need to be fixed.

23.8 The government needs to ensure that departments and agencies setting up new arrangements address the essential issues of credible reporting to Parliament and the public, effective accountability mechanisms, adequate transparency and protection of the public interest. The Treasury Board Secretariat's leadership and commitment are needed in developing a governing framework and overseeing its use, recognizing that what constitutes appropriate and adequate specific provisions to address these issues will vary from case to case.

23.9 There is a balance to be struck between the independence these arrangements need to operate efficiently to achieve results and the need for adequate accountability. In our view, appropriate accountability to Parliament and the public is not incompatible with independence from government intervention in operational matters.

The response of the Treasury Board Secretariat is included at the end of the chapter. The Secretariat endorses the elements of the governing framework we propose, stresses the need for flexibility in their application and acknowledges the need for improvement in some areas. The Secretariat mentions several steps it is taking to address issues identified in this chapter.

Introduction

The federal government is using new governance arrangements

23.10 Government programs and services have traditionally been delivered to Canadians by departments and agencies that report directly to ministers and are subject to common administrative rules and regulations. The government has also created Crown corporations to deliver public services that it believes should be delivered at arm's length from government. Most Crown corporations are subject to a common accountability and control regime. More recently, the government has used new, alternative approaches to deliver its programs and services.

23.11 Many new initiatives stay within the traditional model of ministerial accountability to Parliament. Examples are Crown corporations, special operating agencies like the Passport Office, and service agencies such as the Canadian Food Inspection Agency, the Canadian Parks Agency and the new Canada Customs and Revenue Agency.

23.12 In some cases, the government has involved outside organizations in delivering federal programs as its service providers or as its agents. It has expanded its use of contracting for goods and services. For example, Public Works and Government Services Canada has contracted for property management services covering some 300 federal buildings (see Chapter 18 of this Report), and National Defence has implemented Alternative Service Delivery arrangements for several of its non-core support activities (see Chapter 27 of this Report). In these cases, the federal government is still in control of policy and operations, and ministers remain directly accountable to Parliament.

23.13 A change in how Canadians are governed. Some of the government's

current initiatives have moved beyond the traditional forms of governance of federal public policy — of directing and managing the interests of the state. Under these **new governance arrangements**, the federal government involves other parties in the planning, design and achievement of federal objectives, replacing delivery by federal employees, contractors or agents. In effect, federal governance has been shifted to outside entities that are not accountable to ministers and Parliament.

23.14 Arrangements where the federal government *shares* policy formulation, risk and operational planning, design and management with another party or parties who deliver programs and services are called **collaborative arrangements** in this chapter. Those in which the federal government, within a policy framework it has set out, has *delegated* key planning and operational decisions to the discretion of another party are called **delegated arrangements**. Exhibit 23.1 summarizes both the traditional approaches to program and service delivery and some of the new arrangements that are being tried.

23.15 New governance arrangements need to balance efficiency, accountability and results. Initiatives of this kind have been implemented in many jurisdictions. We recognize that new governance arrangements have the potential for greater efficiency, flexibility, citizen participation and client satisfaction and that departing from traditional models of delivery to experiment with new forms represents a calculated risk. As noted in our April 1999 Report (Chapter 5), to best serve the public interest, improved efficiency and the achievement of results need to be balanced with adequate accountability.

Principles of parliamentary control and accountability are challenged

23.16 New governance arrangements pose a challenge to principles of Parliamentary control and accountability

Under new governance arrangements, federal governance has been shifted to outside entities that are not directly accountable to ministers and Parliament.

To best serve the public interest, improved efficiency and the achievement of results need to be balanced with adequate accountability.

Parliament's ability to control and scrutinize the breadth of federal public policy may be compromised.

that are long-established. Accountability for federal spending and for the use of federal authorities can be at risk in arrangements that involve others in governing who are not directly accountable to a minister and are not subject to parliamentary scrutiny. Unless these arrangements specifically provide for them, mechanisms to ensure adequate accountability through ministers to Parliament and to the public will not be present and Parliament's ability to control and scrutinize the breadth of federal public policy may be compromised.

23.17 The government has recognized this challenge:

Departments share, but do not abdicate, their responsibilities when they enter into partnerships; they remain accountable and answerable to Parliament for the consequences of their involvement in such arrangements. (*Treasury Board Secretariat, Citizen-Centred Service and the Partnership Option*, 1998)

23.18 Essential elements in new governance arrangements. In our April

Exhibit 23.1

Federal Approaches to Program and Service Delivery

Organizational Form	Key Features	Examples
Traditional Ministerial Accountability Arrangements		
Departments and Agencies	Federal entities reporting directly to a minister and subject to the administrative rules and regulations of Treasury Board and the Public Service Commission.	Transport Canada Statistics Canada Immigration and Refugee Board
Crown Corporations	Federal entities that have a board of directors, are involved in a federal public policy purpose and report through a minister to Parliament.	Export Development Corporation Canada Post Corporation Canadian Broadcasting Corporation
New Arrangements Under Direct Ministerial Accountability		
Special Operating Agencies	Remains part of a federal department, reporting to a deputy minister.	Passport Office
Service Agencies	A federal entity with its own CEO reporting to a minister but with greater administrative autonomy than a department.	Canadian Food Inspection Agency Canadian Parks Agency Canada Customs and Revenue Agency
New Governance Arrangements		
Collaborative Arrangements	Partnering arrangements with other levels of government, the private and/or the voluntary sectors, where policy and operational decision-making and risk are shared among partners.	Labour Market Development Agreements Canada's Model Forest Program
Delegated Arrangements	Arrangements where the federal government confers discretionary authority and responsibility over program design, planning, management and delivery of federal functions to independent outside bodies, usually corporate boards of directors, within a broad strategic policy framework provided by the government.	Canada Foundation for Innovation Canadian Television Fund The St. Lawrence Seaway Management Corporation

1999 Report, Chapter 5, we identified the elements of accountability, transparency and protection of the public interest that are essential in collaborative arrangements — that is, arrangements where the federal government shares policy or program management with other parties. These same elements apply, with some adjustment, to delegated arrangements — those where program management has been shifted to an organization outside the government. Exhibit 23.2 sets out a general governing framework for these new arrangements, which includes the elements of accountability (separated into reporting and accountability mechanisms), transparency and protection of the public interest; specific attributes of each element are presented. These two accountability elements are based on our previous audits and studies of accountability arrangements, which have identified key attributes of strong accountability: clear and agreed expectations, clear roles and responsibilities, balanced expectations and capacities, credible reporting, and reasonable review, program evaluation and audit.

23.19 These elements and attributes are stated as general conditions; their particular application to each new governance arrangement will need to be considered. On the one hand, given the wide range of arrangements, a “one size fits all” approach to developing a suitable governing structure will not work. On the other hand, by their very nature these arrangements step outside — and hence cannot be expected to necessarily rely on — the federal government’s established regimes of public management, administration and accountability such as human resource management regimes, the framework of the *Financial Administration Act* and the traditional role of a minister. In each arrangement, those involved need to develop an appropriate governing framework that addresses the essential elements.

23.20 The government has, at various times, suggested similar elements of an effective accountability regime for arrangements with other parties. Recently, other jurisdictions as well as the voluntary sector in Canada proposed quite similar elements of accountability and good governance in their own operations (see Appendix A).

23.21 Our governing framework is based on two fundamental principles of parliamentary democracy:

- **Parliamentary sovereignty over federal policy.** Whoever holds discretionary authority to spend federal taxpayer money or to execute federal authority must not be exempt from potential scrutiny by Parliament.
- **Stewardship of the public trust.** Any arrangement delivering federal

A governing framework for new arrangements includes elements of accountability, reporting, transparency and protection of the public interest.

Exhibit 23.2

A Governing Framework for New Arrangements

To ensure credible reporting:

- Clear public objectives
- Concrete performance expectations
- Appropriate performance measurement and reporting regime

To establish effective accountability mechanisms:

- Clear roles and responsibilities
- Performance expectations that are balanced with capabilities
- Well-defined management structure
- Appropriate monitoring regime
- Partner dispute resolution mechanisms
- Specific evaluation provisions
- Procedures to deal with non-performance
- Appropriate audit regime

To ensure adequate transparency:

- Public access to information
- Communication of information on key policies and decisions

To protect the public interest:

- Citizen complaint and redress mechanisms
- Public consultation/feedback mechanisms
- Policies to promote pertinent public sector values

programs and services must respect the public trust, observing public sector values of fairness, impartiality and equity.

Focus of the audit

23.22 We undertook this audit for several reasons. The government's use of these new governance arrangements was perceived to be increasing. Both this Office and members of Parliament have expressed concerns about the accountability and transparency of some of the new arrangements. Accountability and good governance issues surrounding many of these forms of delivery have had no clear answers. Other national jurisdictions, in particular the United Kingdom and Australia, are questioning and examining similar innovative arrangements. For all these reasons, we believed the audit was timely even though many of the arrangements we looked at were created only recently.

23.23 Our audit focussed on the regimes set up in new governance arrangements to address good governance and to maintain accountability for the federal public trust they manage. We sought to determine the extent to which these new governance arrangements since 1990 are being used by the federal government. In a number of selected arrangements, we also sought to assess whether the formal provisions and subsequent practices for reporting, accountability mechanisms, transparency and protection of the public interest are adequate. We did not audit the effectiveness of these arrangements in achieving the objectives for which they were established. Finally, we examined the guidance provided both by central agencies and by sponsoring departments in the creation of these new governance arrangements.

23.24 All new governance arrangements involve parties outside the federal government. We did not audit those parties. Rather, we audited the

federal government's involvement in these arrangements and the mechanisms established to manage its relationship with its partners in them.

23.25 **We excluded several types of arrangements.** As our focus was on new governance arrangements, we excluded such arrangements as contracting for goods and services and arrangements with international partners. We also excluded most partnering arrangements in Environment Canada and self-government arrangements in Indian and Northern Affairs Canada.

23.26 Further details on our audit objectives, criteria and approach, and on the types of arrangements excluded from our scope, can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

How Many Arrangements Are There?

The government does not know the extent of new governance arrangements

23.27 Since the start of the decade, the federal government has encouraged departments to look for new ways of performing federal functions, in particular by involving other governments and the private and/or voluntary sectors.

23.28 We wanted to find out how many of these new arrangements have been created, the expenditures involved and what basic forms they take. The government could not provide us with an inventory of Alternative Service Delivery arrangements, nor of the new governance arrangements they include. We therefore undertook a government-wide survey.

Use is significant and growing

23.29 We distributed our survey to 49 departments and agencies, asking for

information on all their existing arrangements created since 1990 that met our definitions. Twenty-four had no new governance arrangements.

23.30 Our survey found a total of 77 new governance arrangements, set up by 25 departments and agencies; 51 of these are collaborative arrangements and 26 are delegated arrangements. Appendix B provides basic information on them. As Exhibit 23.3 illustrates, there has been a significant growth in the use of new governance arrangements since 1990.

23.31 We found that the classification of arrangements into collaborative and delegated was not always apparent. For example, those involving a form of contracting for services that gives contractors significant administrative independence come close to being delegated arrangements. The key distinction was whether the government has delegated to a non-federal party significant management discretion in the delivery of federal public objectives. But the dividing line was not always clear. One example is Human Resources Development Canada's sector councils that develop and implement national human resource development strategies; we classified these as **borderline arrangements** and did not include them in our survey results. We also found other types of borderline arrangements we did

not include, where the federal government has promoted and sponsored an entity to effectively take over federal responsibilities but where there are no federal moneys, direct involvement or currently owned assets, even though the federal government retains a degree of legal, constitutional or political interest. Examples include NavCanada, which fulfills Canada's national and international responsibilities for air traffic control, and Strait Crossing Bridge Ltd., which delivers part of the federal constitutional obligation to provide transport links between Prince Edward Island and the rest of Canada.

23.32 Of the 77 arrangements identified, 44 (57 percent) are concentrated in six departments and agencies: Agriculture and Agri-Food Canada, Canadian Heritage, Fisheries and Oceans, Human Resources Development Canada, Natural Resources Canada and Industry Canada.

23.33 In addition, 17 of the 77 are "models" and consist of more than one agreement. For example, Canada's Model Forests Program involves agreements with 11 entities. If the list of arrangements were expanded to include all such agreements, the total number of new governance arrangements would be over 280.

23.34 The federal financial commitment has also grown, with over

There has been a significant growth in new governance arrangements since 1990. The federal financial commitment is over \$5 billion annually.

Number

50 –

40 –

30 –

20 –

10 –

1990

1991

1992

1993

1994

1995

1996

1997

1998

Exhibit 23.3

Cumulative Growth in New Governance Arrangements
1990–1998

Collaborative Arrangements
Delegated Arrangements

\$5 billion now being spent annually under new governance arrangements (see Exhibit 23.4).

23.35 The federal financial commitment to new delivery arrangements varies greatly and in many cases is quite small. However, as shown in Exhibit 23.5, the federal contribution to some arrangements over the last few years has been quite substantial.

23.36 The government's partners in new governance arrangements have contributed \$11 billion, or about 30 percent of total funding (see Exhibit 23.6).

The Need for a Governing Framework and Central Guidance

23.37 Organizational change within government involves a range of central players with different responsibilities and expectations. The Privy Council Office is the central agency involved in machinery-of-government issues, that is, the form and design of departments and agencies. The Department of Finance approves provisions that deal with the government's overall financial commitments. The Treasury Board Secretariat (TBS) has the responsibility to provide advice to Treasury Board ministers and government departments on

Exhibit 23.4

Annual Federal Expenditures Through New Governance Arrangements

Source: Office of the Auditor General Survey

Fiscal Year	(\$ billions)		
	Collaborative	Delegated	Total
1997–98	1.9	2.9	4.8
1998–99	3.8	0.8	4.6
1999–00	4.5	0.7	5.1*

*Difference due to rounding

Exhibit 23.5

Arrangements With Federal Commitment Over \$1 Billion

Source: Office of the Auditor General Survey

Collaborative Arrangements	
Labour Market Development Agreements	\$7.7 B between 1995–96 and 1999–00
National Child Benefit	\$3.8 B between 1998–99 and 2000–01; \$1.7 B per year thereafter
Canada Infrastructure Works Program	\$2.4 B between 1994–95 and 1999–00
Regional Bilateral Agreements	\$2.2 B between 1996–97 and 2003–04
Delegated Arrangements	
Canada Millennium Scholarship Foundation	\$2.5 B 1997–98, to be spent over 10 years
Canada Foundation for Innovation	\$1.0 B between 1996–97 and 2002–03

Exhibit 23.6

Total Federal and Partner Contributions to New Governance Arrangements, 1990–1999

Source: Office of the Auditor General Survey

Type of Arrangement	Federal Contributions (\$ billions)	Contributions by Partners (\$ billions)
Collaborative	19.6	8.6
Delegated	6.6	2.9
Total	26.2	11.4*

*Difference due to rounding

the implementation of change, as it relates to human, financial, information and technology resources. It provides assistance to departments seeking to establish new and innovative forms of program delivery known as alternative service delivery mechanisms (ASDs).

23.38 We expected that the central players would provide departments with timely and appropriate guidance on operational issues, as well as on broader issues of design of the arrangements, to reflect the essential elements of accountability and good governance. We also expected that central agencies would generally monitor the establishment of new arrangements — including new governance arrangements — and assess their usefulness and appropriateness as tools of public policy, learn from the experience and communicate that learning across government.

23.39 We were informed that the Privy Council Office has had minor involvement in providing guidance or advice on negotiating and managing the new arrangements that we examined in this audit. The Department of Finance was involved in selected cases, for example, the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation.

Guidance is limited

23.40 Framework for Alternative Program Delivery is not used. Program Review prompted Treasury Board Secretariat's ASD division (created in 1994) to develop the *Framework for Alternative Program Delivery*, which identifies some categories of alternative service delivery. We examined the Framework's applicability to new governance arrangements.

23.41 The Secretariat's Framework, developed in 1995, provides broad strategies for developing these kinds of arrangements, along with a checklist of questions on the public interest, service

quality, resource management and human resources that need to be considered when assessing proposed new methods of delivery. Although it sets out a general requirement for accountability, it is not clear on what constitutes an appropriate accountability regime, particularly in non-traditional arrangements outside the direct control of the federal government. Nor does it contain specific information about requirements for transparency and for protection of the public interest. The Treasury Board Secretariat has provided further information in recent publications, namely, *Citizen-Centred Service and the Partnership Option* (1998) and *Impediments to Partnering and the Role of Treasury Board* (1998). However, it has not yet updated its *Framework for Alternative Program Delivery* to reflect departmental experience with ASDs in general or with, in particular, the types of new governance arrangements we discuss in this chapter. In most of the arrangements we examined, we noted that sponsoring departments had not used the 1995 Framework for Alternative Program Delivery. Officials at the Secretariat informed us that plans have been made to update the Framework for March 2000.

23.42 We observed that most departments that have sponsored new governance arrangements do not have centres of expertise responsible for providing guidance, monitoring implementation and documenting best practices. Few departmental managers have much experience in setting up new arrangements. In the absence of clear guidance, some departmental officials have developed their own informal networks to share experiences. Some departments have made attempts to provide guidance and capture lessons learned from their experiences. Environment Canada has documented lessons learned and has prepared a number of management frameworks for the programs it delivers with partners outside the federal government (see Exhibit 23.7).

The Treasury Board Secretariat's Framework for Alternative Program Delivery is not clear on what constitutes an appropriate accountability regime.

There is no consistent governing framework or other guidance from the centre specifying how, in designing new governance arrangements, departments are to ensure that the flexibility the new arrangements need to work efficiently is balanced with the requirements of good governance and accountability to Parliament.

23.43 The Secretariat has approached the creation of new governance arrangements on a case-by-case basis, providing advice through ad hoc teams of experts in areas such as financial management, human resource management and alternative service delivery. There is no centre of expertise responsible for co-ordinating guidance, monitoring implementation and documenting best practices. The ASD division of the Secretariat is responsive, providing advice when requested. It does not take the lead in giving advice.

23.44 In our interviews with departmental managers tasked to develop and implement new governance arrangements or other ASD initiatives, a common theme was the lack of clear direction and guidance from the central agencies of government, particularly in addressing the elements of accountability and good governance. There is a clear need to better co-ordinate and manage the guidance provided to departments by the Secretariat's various policy centres in the creation of new arrangements. Also needed is a consistent message.

23.45 **There is no consistent governing framework.** In a number of publications, the Secretariat has identified

some elements of a governing regime for alternative service delivery mechanisms that are also applicable to new governance arrangements. One is a joint paper developed with this Office, *Modernizing Accountability Practices in the Public Sector*, which is the basis of the framework we suggest in Exhibit 23.2. But there is no consistent governing framework or other guidance from the centre specifying how, in designing new governance arrangements, departments are to ensure that the flexibility the new arrangements need to work efficiently is balanced with the requirements of good governance and accountability to Parliament. We found no consistent approach to establishing governing frameworks for new governance arrangements. Even if a standard governing framework existed, the Secretariat would need a more structured and committed approach than it presently has to oversee its implementation.

23.46 **The Treasury Board Secretariat should clearly identify and communicate the essential elements of an effective governing framework for new governance arrangements and provide departments with consistent guidance on its use when they design and implement new arrangements.**

Exhibit 23.7

Environment Canada: Building on Experience

Environment Canada has a long tradition of recognizing the importance of collaborative arrangements as a means of engaging citizens and sharing ownership of problems and solutions, and encouraging results. Its Ecosystem Initiatives are an example. Through evaluations Environment Canada with its partners has identified and addressed challenges in its programs and documented lessons learned. This process and extensive consultations within the Department and among partners led to the development of the Planning and Management Framework for Ecosystem Initiatives — a key guide for future decision making.

Some lessons learned through evaluations of the Ecosystem Initiatives. There is a need for clear accountabilities and performance indicators; information must be shared among all partners; and procedures need to be jointly established. Lessons learned have been incorporated in the Framework and were applied recently in implementing the Northern Rivers Ecosystem Initiative.

Notwithstanding these positive developments, challenges remain. We observed that the Framework does not contain explicit guidelines for accountability — for example, the need to provide for clear roles and responsibilities among partners and agreed expectations. Environment Canada notes that memoranda of understanding and other means are used to document roles and responsibilities, and it is preparing a national evaluation framework to more clearly define accountabilities for the planning and monitoring of goals, objectives and results.

Source: Office of the Auditor General; Environment Canada

The framework should provide for:

- appropriate reporting to Parliament and the public on the extent to which the arrangement has achieved its federal public policy purpose and on the expenditure and investment of federal moneys and the stewardship of federal assets;
- effective accountability mechanisms to ensure that adequate and appropriate evaluation and audit regimes are established;
- adequate transparency of important decisions on the management and operations of the arrangement; and
- protection of the public interest so that delivery of the federal objective adheres to essential and traditional values of public sector administration.

Monitoring helps to identify strengths and weaknesses of new governance arrangements

23.47 As already noted, the government could not provide us with an inventory of the number, types and expenditures of new arrangements created. The Treasury Board Secretariat does prepare an annual report to Parliament entitled *Crown Corporations and Other Corporate Interests of Canada*, which lists each entity to whose governing body the federal government has a legal right to appoint or nominate one or more members. As such, it provides limited information on some of the delegated arrangements identified in our survey, but not all. It does not include, for example, federal representatives who are made directors pursuant to a contribution agreement. In addition, the President of the Treasury Board tables an annual report in Parliament, which in recent years has identified as examples a few of the intergovernmental initiatives that were also captured in our survey as collaborative arrangements. Thus there is reporting to Parliament by the Secretariat on some new governance arrangements,

but it is very limited. These reports could be used to present a more complete picture to Parliament.

23.48 Further, the Treasury Board Secretariat has not tracked or evaluated trends, successes or issues emerging from the establishment of these new arrangements. It does not monitor new arrangements to see which types work as policy tools, despite its access to a broad range of departmental documents that presumably would mention them (Treasury Board Submissions, Reports on Plans and Priorities, Business Plans and Departmental Performance Reports). Consequently, it has not assessed the appropriateness of the use of new governance arrangements, what they cost and how effective or responsive they have been.

23.49 Lessons learned as a springboard for new governance arrangements. TBS has acknowledged the need to develop its capacity to assess the results of new forms of delivery arrangements, to capture lessons learned, and to communicate these lessons to the managers of existing arrangements and those proposing new ones. An understanding of the benefits and potential difficulties inherent in new governance arrangements would help departments considering them to overcome the shortcomings we identified in the audit and to avoid “reinventing the wheel”.

23.50 The ASD division of the Treasury Board Secretariat recently made an effort to document lessons learned on the benefits, risks and costs involved in selected alternative service delivery initiatives. However, the attention given to new governance arrangements has been very limited. We were informed that officials in the ASD division plan to develop a guide on management practices for new service delivery arrangements, including new governance arrangements, as well as a database on best practices and a process for updating it. The projected

The Treasury Board Secretariat has not reported overall on the extent to which arrangements are being used, what they cost and how effective or responsive they have been.

time for completion is early 2000. We support this effort.

23.51 The Treasury Board Secretariat should:

- collect and make available more complete information on the types and extent of use of new governance arrangements that federal departments and agencies create;
- develop an evaluation framework and, after an appropriate period, evaluate the use of new governance arrangements as tools of public policy. The Secretariat should communicate the findings government-wide and report a summary of the evaluation to Parliament; and
- gather information on lessons learned and good practices identified in new governance arrangements, and communicate this information to government managers.

Collaborative Arrangements: Sharing Governance

23.52 We defined collaborative arrangements as those that involve the federal government and either provincial governments and/or partners in the private or voluntary sector and in which decisions about collective activities are shared, along with risks. As Exhibit 23.8 shows, in almost half of the 51 collaborative

arrangements identified by our survey, the departments had only non-government partners, and in about one quarter they had only government partners. Appendix B provides a list of those arrangements identified by our survey.

23.53 Our cases. We selected 10 collaborative arrangements to examine. They cover a range of types, and include those with the largest federal financial commitments but also some involving little federal spending. Appendix C provides basic information on each of these arrangements, including their purpose, partners and financial commitments involved.

23.54 What we examined. We expected the arrangements to have appropriately addressed the elements of accountability and good governance. Exhibit 23.9 provides an overview of the 10 collaborative arrangements we examined, identifying the number of arrangements where selected key attributes and related features are present in the governing framework.

Performance reporting is occurring

23.55 Given that the new governance arrangements are outside the normal federal reporting regimes (in particular, the Estimates process) yet still involve a significant federal interest, we expected them to have a governing framework that:

- states clearly the objectives they are trying to achieve;
- includes in agreements or subsequent documents more specific statements about the results expected from the arrangement and for each of the parties involved; and
- makes appropriate provision for reliable measurement of the results achieved and for reporting on them to the parties involved, the ministers responsible, Parliament and the public.

23.56 While there is some form of reporting on the collaborative arrangements we examined, we found that

Exhibit 23.8

Types of Partners in Collaborative Arrangements With Federal Departments

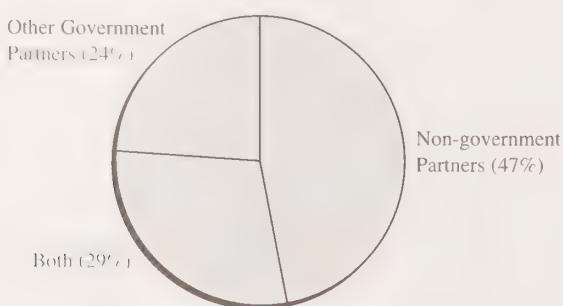
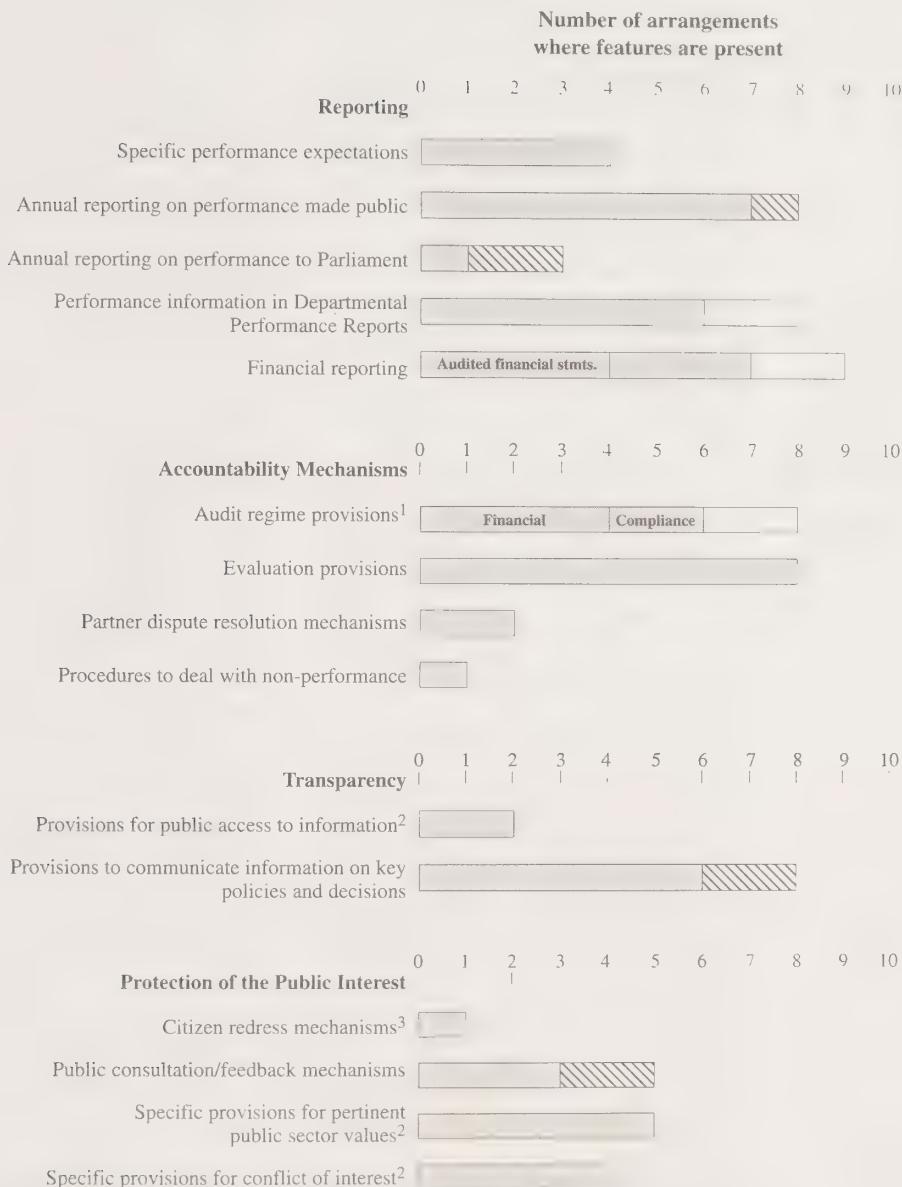


Exhibit 23.9

Key Features Present in the Ten Collaborative Arrangements Examined



Notes: ¹ Audit provisions in addition to value-for-money audits of the federal partner.

² Refers only to formal requirements in the arrangements. Relevant federal and provincial legislation/policies also apply.

³ Refers only to the federal component of the arrangement. Provincial or private sector partner may have redress mechanisms.

Yes, formal requirement or feature Yes, voluntary Not applicable

performance measurement practices need more attention and that reporting to Parliament is generally weak and sometimes absent.

23.57 Public objectives are clear but specific performance expectations are not. Documents we examined for the 10 collaborative arrangements frequently state the public objectives clearly so that the general purpose is known. However, for the most part we found that performance expectations, when identified, tend to focus on outputs and not the accomplishments that are expected of each partner. Without more concrete outcome expectations, it is hard to translate good intentions into effective action that each partner should take. Further, it will be difficult or impossible later to judge and report on the success of the arrangement. We did note exceptions. For example, Canada's Model Forests Program (Foothills Model Forest) has tailored performance expectations to regional needs and to measurement of outcomes at the local level.

23.58 Performance information is being reported. According to our survey, about 55 percent of collaborative arrangements are required to report what they have accomplished. Another 27 percent report only on the activities they have undertaken. Sixteen percent have no requirement to report on performance, but most in this group involve little or no federal funds.

23.59 In the 10 collaborative arrangements we examined, we found that seven require performance reports that are

publicly available. However, we found shortcomings in the nature of their performance reporting. The kinds, quality and quantity of data they report vary widely. Employability Assistance for People with Disabilities is an example: the provinces and Human Resources Development Canada are committed to annual reporting but to date there is no agreement on the specific format, substance, or timing of an annual report. Nor are there yet specific targets to be met over any time frame. We observed no structured reporting in other arrangements as well, although efforts were under way to improve reporting practices.

23.60 Some information reported to Parliament. We recognize that it is neither reasonable nor desirable to expect all new governance arrangements to report to Parliament in detail on their performance, and doing so would overwhelm Parliament with information. Appropriate reporting to Parliament would depend on the significance of the arrangement (see Exhibit 23.10). By reporting to Parliament we mean using, as appropriate, one of these approaches.

23.61 We found that for the arrangements examined, selected financial, performance or evaluation information has been provided in sponsoring departments' Performance Reports but the extent of the information varies.

23.62 The Canada-Alberta Labour Market Development Agreement was the only arrangement that had formal provisions for reporting information to

Exhibit 23.10

Appropriate Reporting to Parliament

Size of Arrangement	Appropriate Reporting
<i>Small</i>	Reference in Departmental Performance Report (except for very small arrangements)
<i>Medium</i>	Reference in Departmental Performance Report to a publicly available performance report
<i>Significant</i>	Summary of annual performance in Departmental Performance Report
<i>Very significant or legislated</i>	Separate performance report tabled in Parliament

Parliament directly and on a regular basis. In other large arrangements such as Employability Assistance for People with Disabilities and the National Child Benefit, there is no requirement to report to Parliament.

23.63 Comparability and sharing of performance data need attention. A common problem in collaborative arrangements that was identified in several of our case studies is ensuring that data collected by the different partners are reliable and compatible. The credibility of reporting on the arrangement's overall performance requires that the data each partner collects and reports be relevant, accurate, verifiable, and sufficiently comparable with other partners' data. Of course, data sharing may be constrained by legitimate concerns for individual privacy, commercial confidence and future negotiations between levels of government. We expect that any such restrictions would be spelled out explicitly.

23.64 Departments sponsoring collaborative arrangements should provide for the reporting of timely, appropriate and credible information to Parliament and the public on the extent to which the arrangements have accomplished their federal policy objectives, and at what cost. They should ensure that:

- expectations about what the arrangement and each of its partners are to accomplish are stated in clear and concrete terms; and
- agreement is reached on the collection and sharing of reliable and compatible data.

Many essential accountability mechanisms are not in place

23.65 Existing federal mechanisms for accountability do not apply to new governance arrangements unless specific provision is made, or apply only to the

ongoing federal part of the arrangement. We expected that provisions would be made in these arrangements to ensure:

- clearly specified roles and responsibilities of the parties;
- performance expectations balanced with the capacity to deliver;
- a well-defined structure to manage the arrangement;
- an appropriate monitoring regime whereby the federal government can assess whether the arrangement is accomplishing what is expected;
- appropriate evaluation of the success of the arrangement;
- mechanisms for resolving any disputes among partners;
- reasonable procedures to deal with non-performance in aspects of the arrangement; and
- a clearly defined and appropriate audit regime.

We did not look at all of these attributes in examining the 10 collaborative arrangements; we did not look at management structures or monitoring regimes. In the latter case, since the federal government is a partner in the arrangements, federal monitoring is occurring to some extent.

23.66 We found that several of these attributes are generally in place but that many important mechanisms to help ensure accountability are not.

23.67 Assessment of partners' ability to deliver is inadequate. In the collaborative arrangements we examined, partner roles are generally spelled out clearly. However, we found no evidence that before entering into an arrangement the federal government had conducted any systematic assessment of its prospective partners' ability to discharge their responsibilities. Without such assessment the arrangement is at risk, especially if

Existing federal mechanisms for accountability do not apply to new governance arrangements unless specific provision is made, or they apply only to the ongoing federal part of the arrangement.

In most of the 10 arrangements we examined, the partners had agreed on mechanisms for evaluation.

there are no dispute resolution mechanisms in place. The Commissioner of the Environment and Sustainable Development made the same observation in Chapter 5 of his 1999 Report, on federal-provincial environmental protection agreements.

23.68 Dispute resolution mechanisms and provisions for non-performance are lacking. Only two of the arrangements we examined provide for dispute resolution mechanisms to help resolve conflicts before they escalate. Given the general absence of formal dispute mechanisms, we looked at the arrangements to see what recourse partners have, short of termination, when parts of the arrangement are not respected or when a partner does not fulfil its responsibilities. None of the arrangements provide for ways to deal with non-performance. Only one, the Loan Investment Fund Program, sets out conditions under which the agreement may be terminated.

23.69 Officials indicated to us that putting dispute resolution and sanction mechanisms in place would be onerous; it would slow down and overly formalize relations among the partners. We were also informed that “pushing accountability too hard” undermines trust and thereby weakens accountability further. While we appreciate these concerns and the importance of trust among partners, dispute resolution mechanisms are an important aspect of managing with partners and are quite common in the private sector. The success of collaborative arrangements depends on all partners fulfilling their respective responsibilities, including the responsibility to hold others to account and take corrective action when necessary.

23.70 Before entering into collaborative arrangements, departments should carry out an assessment of prospective partners’ ability to deliver their part of the arrangements. Departments should also

ensure that the arrangements include dispute resolution mechanisms and identify the actions that can be taken in the event that partners in the arrangement do not fulfil their responsibilities.

23.71 Creating an effective audit regime for collaborative arrangements. Traditionally, government departments are subject to external audit as a means of ensuring accountability to Parliament for federal spending and the use of federal authorities. However, the audit regimes of the 10 collaborative arrangements we examined are fragmented, and audit responsibilities are usually not well specified. For example, in arrangements with provincial partners, provincial legislative auditors might look at provincial department expenditures and the Auditor General of Canada might examine the federal department’s involvement. In no case was there provision for audit of the whole of the arrangement.

23.72 Nor did we find provision in the arrangements for co-ordinated or joint audit work, or for reliance on the audit work of a partner. In one case — Canada Infrastructure Works Program — some joint audit work (federal-provincial) has been done. However, since each legislative auditor is independent, there is no requirement to carry out a joint audit. Yet without one, the respective legislative bodies are unlikely to get adequate audit assurance on the arrangement as a whole. Legislative audit offices in Canada are discussing ways to carry out effective joint audit work in such cases.

23.73 There are evaluation provisions in place. We did observe in most of the 10 arrangements that the partners had agreed on mechanisms for evaluating the extent to which the objectives of the arrangement have been met (see Exhibit 23.9). Although only 61 percent of the collaborative arrangements identified by our survey reported that an evaluation was planned or under way, all

arrangements with large financial commitments have evaluation requirements. Our survey shows that evaluation is more likely to be required where the partners are the federal and provincial governments. Evaluation is one way to provide governments, Parliament and provincial legislatures with information on how well the arrangement is working.

23.74 Sponsoring departments, before entering collaborative arrangements, should agree with their partners on appropriate evaluation plans and an external audit regime that includes, as appropriate, financial, compliance and value-for-money audits of the arrangements, co-ordinated as required with the legislative audit offices of the governments involved.

Transparency needs attention

23.75 Given their complexity and their less familiar organizational structures, we expected that new governance arrangements would:

- be as open as possible with access to information on the agreements, objectives, activities and achievements; and
- actively communicate such information to the public and stakeholders.

23.76 Different partners may have different policies on access to information. To the public and to users trying to obtain information, collaborative arrangements often appear to be a maze since they involve several organizations and governments. With several different partners, some with their own access-to-information regimes and others perhaps with none, we expected to see specific formal provision made for consistent and compatible transparency rules.

23.77 We found few collaborative arrangements whose design sets out adequate and specific provisions for

public access to key information. As a result, disclosure is often restricted. Indeed, conflicts can arise between the separate regimes of disclosure that apply to federal and provincial partners. None of the arrangements we examined that involve private sector partners have specific provisions for information disclosure.

23.78 We found that collaborative arrangements generally have provisions to publicize information on their key decisions, policies and processes. Some arrangements issue press releases and others issue public information notices. The use of Web sites to disseminate information to the public is increasing. All the arrangements we examined have Web sites that provide some type of information. We see this as effective use of the Internet to enhance transparency.

23.79 Departments entering into collaborative arrangements, especially with partners in the private or the voluntary sector, should ensure that there are clear provisions for transparency among the partners in the arrangement.

Mechanisms to protect the public interest are often weak

23.80 Canadians expect federal authority to be exercised with fairness, equity, honesty, prudence and openness. We expected that new governance arrangements would provide adequate protection of the public interest, through:

- citizen complaint and redress mechanisms;
- public consultation and feedback mechanisms; and
- policies to promote pertinent public sector values and instil a notion of public trust.

Public sector values, tailored to the specific arrangement, would cover such areas as the primacy of the public good and the rule of law, along with other

values promoting the availability of services in French and English where demographics warrant, personal privacy and cultural diversity, among others.

23.81 Traditional mechanisms to protect the public interest need attention. Although all the collaborative arrangements we examined have some provisions for protecting the public interest, none has all the essential provisions (see Exhibit 23.9). This is perhaps a lesser problem when the arrangement involves only governments as partners, since each has its own conflict-of-interest codes and policies on public sector values. However, it is not enough when dealing with multiple partners to rely solely on existing government legislation and policies. There may be gaps or inconsistencies among jurisdictions that need to be addressed in negotiating a particular arrangement. There are federal areas that do need to be considered when the arrangements are established, such as official language requirements.

23.82 We would expect that federal departments would pay special attention to ensuring appropriate protection of the public interest in arrangements that include partners from the private sector, where many traditional public service values do not apply. Non-governmental partners were involved in about three quarters of the collaborative arrangements identified in our survey, and four of the 10 arrangements we examined. Two of these have mechanisms for public input, policies on official languages and conflict-of-interest codes.

23.83 In many of the arrangements we examined, those responsible are kept aware of their stakeholders' needs and their changing policy and operational environments through regular consultations with stakeholders and informal links to ministers and officials. However, only the Employability Assistance for People with Disabilities

arrangement specifically provides for redress of a citizen's grievances.

23.84 Departments entering into collaborative arrangements, especially with partners in the private or the voluntary sector, should ensure that the arrangements make clear provision for protection of the public interest and, in particular, for procedures to deal with stakeholder and public input and citizen grievances.

Delegated Arrangements: Letting Go

23.85 Delegated arrangements involve non-federal entities that exercise discretionary federal authority in delivering programs and services within a broad policy framework determined by the government. Our departmental survey identified 26 delegated arrangements (listed in Appendix B). Delegated arrangements, like Crown corporations, serve federal purposes. Unlike Crown corporations, they are not owned by the federal government. The government may appoint some directors to their governing boards but usually not a majority, and it has no power to remove directors it did not appoint. Nor does it usually have authority to review and approve corporate plans as it does in the case of Crown corporations.

23.86 We identified two basic types of delegated arrangements: non-profit, independent bodies that exercise discretion in disbursing (and often investing) non-recoverable, federal trust funds, such as the Canada Millennium Scholarship Foundation; and independent entities that operate primarily along business lines (usually corporations) but that draw on, pledge, use or manage federal assets for a federal public purpose, such as The St. Lawrence Seaway Management Corporation.

23.87 Accountability concerns about delegated arrangements are not new. The 1979 Royal Commission on Financial

Management and Accountability (the Lambert Commission), whose main focus was financial management and control and accountability for public funds by deputy ministers and heads of Crown corporations, also noted that there were problems of accountability, performance and disclosure in independent bodies (it called them quasi-public corporations) whose creation the government had sponsored in order to carry out federal functions. The Lambert Commission called on the government to recognize its responsibility and deal with these issues. In 1984 the government established in legislation a control and accountability regime for almost all federal Crown corporations.

23.88 What we examined. In our audit we examined six delegated arrangements as well as one arrangement that has features of both collaborative and delegated arrangements, the Canadian Institute for Health Information. For the purpose of our analysis, we treated this as a delegated arrangement. Appendix D provides basic information on the seven arrangements we examined. Our general expectations for accountability and good governance were the same as we had of collaborative arrangements, although the specifics differed for some elements. Exhibit 23.11 summarizes what we found. To further illustrate how a delegated arrangement works, Chapter 24 reports the results of a more detailed audit of the Canadian Adaptation and Rural Development Fund.

23.89 Delegated arrangements must balance independence and efficiency with accountability. Delegated arrangements are set up to be independent of the day-to-day involvement of the government and to be exempt from its rules and regulations. They are intended to have flexibility and the freedom to take reasonable risks and adopt innovative ways of delivering federal objectives. Yet, as we have noted, they do carry out an explicit federal purpose in which

Parliament and the government maintain a strong, ongoing interest. In our view, appropriate and adequate accountability to Parliament can be balanced with the autonomy and flexibility these arrangements require. Reasonable accountability to Parliament is not synonymous with control by the government and should not necessarily be interpreted as bringing these entities under government control or into the federal accounts, or invalidating their independence. However, in our democratic system, ministers are the traditional link between those who exercise federal authority and Parliament, and they still need to play a role — perhaps along lines similar to that already established for ministers in relation to Crown corporations.

Reporting requirements and practices need improvement

23.90 In the delegated arrangements we examined, the requirements and practices for credible reporting are generally patchy and need attention.

23.91 Performance expectations are not related to objectives. In using delegated arrangements that it does not directly control, the government faces the challenge of ensuring that taxpayers' money is being spent for intended purposes, that federal authority is being exercised properly and that federal objectives are being achieved efficiently. Most of the seven delegated arrangements we examined have clearly stated objectives. Generally, however, these objectives have not been translated into specific performance expectations — what is to be specifically accomplished.

23.92 Measures are output-focussed. Targets, measures and indicators, where they have been identified (the Canadian Television Fund and the Canada Millennium Scholarship Foundation, for example) have focussed mainly on outputs. This is a start, but measuring only outputs will not provide for reporting what

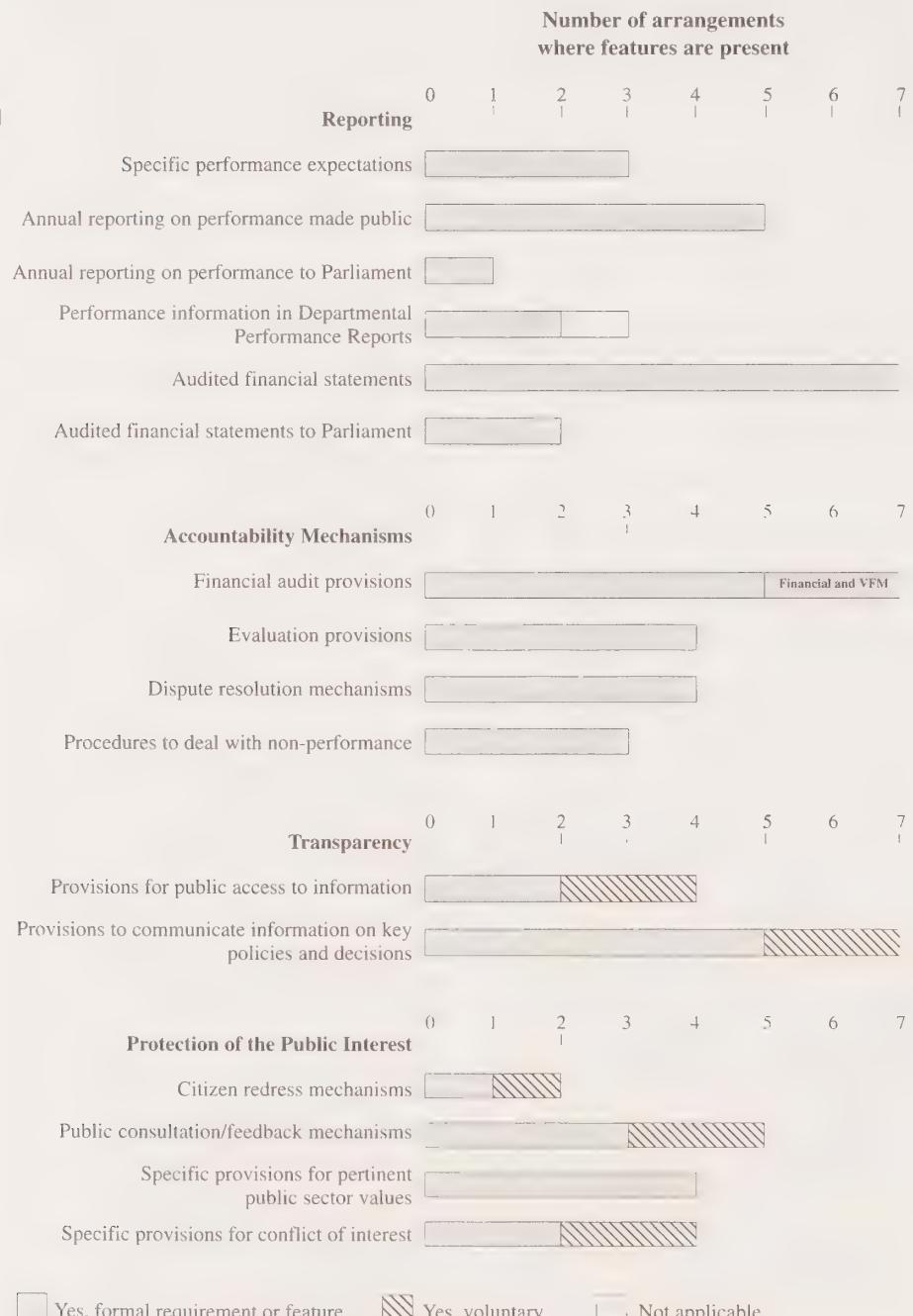
Reasonable accountability to Parliament is not synonymous with control by the government. However, ministers still need to play a role.

has been accomplished in relation to objectives. For example, the Canada Millennium Scholarship Foundation has a target of granting some 100,000 scholarships each year for 10 years (an output). It has no targets for achieving the government's objectives of improving access to post-secondary education and

reducing student debt. The Foundation does intend to track student debt (an outcome measure) but is not required to do so. In the other delegated arrangements we examined, measures of outcomes for the most part have yet to be identified and appropriate information collected.

Exhibit 23.11

Key Features Present in the Seven Delegated Arrangements Examined



Procedures for monitoring outcomes have yet to be established.

23.93 Important baselines have not always been developed. In some delegated arrangements we examined, baselines essential to determining the success of the arrangement have not been developed or identified. For example, the Canada Foundation for Innovation was created to renew Canada's aging research infrastructure, yet it has no baseline figure for the age of the research capital base before the program began. It has no obligation to measure the effectiveness of its spending in reducing the average age of the capital base, nor any target to achieve for age reduction.

23.94 When creating delegated arrangements, sponsoring departments should clearly specify what the arrangements are to achieve, identifying measurable outcomes and timetables as well as concrete outputs. The departments should ensure that the capacity exists to measure the extent to which objectives have been achieved under the arrangement.

23.95 Outcomes often are not reported. Of the 26 delegated arrangements identified in our survey,

departments said that 54 percent are required to report performance information, and another 31 percent to report on activities. All but one of the delegated arrangements we examined publish annual reports and all produce audited financial statements. Almost all of the arrangements we examined are required to report their achievements publicly or to the government. However, we found a lack of consistency in the kind, quantity, quality and depth of detail of performance information required of the arrangements or actually reported by them. Except for the Canadian Adaptation and Rural Development Fund, we found that reporting focusses on activities and outputs, not outcomes. As a result, what has been accomplished in support of federal objectives is not being reported. Exhibit 23.12 presents a reporting framework applied in the legislation creating the Canada Millennium Scholarship Foundation.

23.96 Parliament is often not informed about accomplishments. In our view, information on the financial and results performance of delegated arrangements should be regularly brought into the parliamentary domain through means such as those suggested in

In a 1997 audit observation on the Canada Foundation for Innovation, we stated our view that good accountability in arm's-length arrangements and partnerships begins with a clear description by the government of the goals, planned actions and ends of the arrangement; the party delivering the arrangement must be clearly obliged to give Parliament a full and audited annual account of its financial and operational performance. We also stated that all future arrangements should require program evaluations, reported to Parliament.

Subsequently, in the legislation creating the Canada Millennium Scholarship Foundation, the government included some of these elements. The Foundation's annual reports must contain audited financial statements; a detailed statement of investment activities; a statement on the investment portfolio, policies, standards and procedures; a statement on plans for meeting objectives in the current and next years; a yearly evaluation of results achieved; and a five-year review and report. Annual reports approved by the Board and its members are tabled in the House of Commons by the Minister of Human Resources Development and sent to the appropriate provincial and federal ministers. Annual reports are made available to the public and discussed at an annual public meeting. The legislation did not require the auditing of the performance reports as the Auditor General had called for.

Exhibit 23.12

Reporting Framework: Canada Millennium Scholarship Foundation

Sources: Report of the Auditor General December 1997, Chapter 36, and *Budget Implementation Act 1998*, Part I
Canada Millennium Scholarship Foundation

Parliament does not always receive the performance information it needs to assess whether delegated arrangements are working effectively as tools of public policy.

Exhibit 23.10. Only two of the delegated arrangements we examined report to Parliament: the Canada Foundation for Innovation with audited financial statements, and the Canada Millennium Scholarship Foundation in audited financial statements and an annual performance report. Ministers have made some reference in their Departmental Performance Reports to the existence of the delegated arrangements we examined. However, only in one — the Canadian Adaptation and Rural Development Fund — has any performance information been included. Parliament, then, does not always receive the performance information it needs to assess whether delegated arrangements are working effectively as tools of public policy.

23.97 Sponsoring departments should ensure that timely and credible information on the performance of their delegated arrangements and, where appropriate, audited financial statements of the entities involved are provided to Parliament and the public.

Several accountability mechanisms are weak

23.98 Except as required by special legislation in two cases, the delegated arrangements we examined are not formally obliged to establish accountability mechanisms that are typical of public sector organizations. Often there are no provisions for program evaluation or for dealing with non-performance.

23.99 Roles and responsibilities are well defined and dispute resolution mechanisms are provided. In the delegated arrangements we examined, we found that the roles and responsibilities of the entities involved are spelled out reasonably well. Four of the seven delegated arrangements we examined provide formal mechanisms to resolve disagreements with the government over issues including roles and responsibilities.

23.100 Delegated arrangements do not allow for federal adjustment. The delegated arrangements we examined offer limited scope for the government to adjust the arrangement when circumstances change or performance is off track. The federal government's main instrument of influence is the minority position of its appointees on boards and their membership on key committees. Where there are annual payments from the federal government, the priorities and direction of delegated arrangements can be adjusted by withholding payments or attaching new conditions. All of the arrangements are insulated from direct ministerial intervention, even where there are fundamental policy issues, but three do allow for amendment of terms by written mutual agreement. None of the arrangements, however, has a mechanism whereby the government can intervene to require the entity to modify its operations in respect of its federal function in order to reflect a change in the government's underlying policy framework.

23.101 Only three of the delegated arrangements we examined have formal provisions for dealing with non-performance. Federal officials we interviewed seemed reluctant to address such sensitive aspects of accountability. Short of special legislation, in most cases there are no means of bringing a delegated arrangement back into line or adjusting its public purpose. In our view, ministers need to monitor their arrangements from a strategic perspective, keeping apprised of changes in the policy environment and in the capacities of delegated arrangements to perform their public purpose functions. Sponsoring departments need to be able to take corrective action when arrangements stray from their purpose or when circumstances alter or invalidate their purpose. Only the Canada Millennium Scholarship Foundation, the Canada Foundation for Innovation and The St. Lawrence Seaway Management Corporation address the disbursement of federal moneys and assets in the event that

the arrangements terminate or wind down; in neither of the foundations are the funds recouped by the federal treasury.

23.102 Evaluations are planned or required in many delegated arrangements.

arrangements. Our survey responses indicated that evaluation is planned or under way in 58 percent of the 26 delegated arrangements our survey identified. Four of the arrangements we examined are required to evaluate their programs. In only one case, the Canada Millennium Scholarship Foundation, is the evaluation reported to Parliament. In two cases, the Canadian Television Fund and the Canadian Institute for Health Information, evaluations have been undertaken. While sponsoring departments may have an idea of what is happening in their delegated arrangements, it is through an evaluation that departments can assess the extent to which arrangements are meeting their objectives, as well as their adequacy as strategic tools of public policy.

23.103 Audit regimes are incomplete.

The only external audit of most delegated arrangements is the audit of their financial statements. All the delegated arrangements we examined produce audited financial statements. Only a few are required to conduct value-for-money audits that look at economy, efficiency and effectiveness in their internal systems. For example, The St. Lawrence Seaway Management Corporation is required to periodically undergo a special examination, and this report is made available to the public.

23.104 Although these arrangements are serving federal public policy purposes and using federal assets or funds appropriated by Parliament, Parliament does not receive any assurances on the use of those federal funds, assets and authorities, as it does from departments and Crown corporations. In some cases, especially the commercially oriented delegated arrangements, value-for-money audits

may not be necessary or appropriate. In larger arrangements, however, Parliament would probably want some assurance that federal money is not being wasted and that federal assets are being safeguarded.

23.105 Certainly, Parliament needs fair and reliable information on the performance of all arrangements. In our view, where the independent entities involved in delegated arrangements provide performance reports through ministers to Parliament, the fairness and reliability of the performance information ought to be subject to assessment by an external auditor, parallelling the well-accepted model for financial information. This is the model Parliament has established for the recently created and less independent service agencies.

23.106 Sponsoring departments should ensure that, where appropriate, the design of delegated arrangements provides for:

- formal mechanisms and guidance to resolve disputes with partners;
- means to deal with non-performance and termination of the arrangement;
- periodic program evaluations, the results of which are reported through ministers to Parliament;
- consideration of value-for-money audit; and
- independent assessment of the fairness and reliability of the performance information tabled in Parliament.

Transparency is not assured

23.107 Private sector disclosure

practices are not enough. Delegated arrangements distance the delivery of public policy from direct government control and accountability to Parliament through responsible ministers. Without direct ministerial control, provision needs to be made for enhanced transparency,

Short of special legislation, in most cases there are no means of bringing a delegated arrangement back into line or adjusting its public purpose.

Legitimate concerns about competitive business confidence and individual privacy may be factors that limit transparency.

including access to corporate information that is relevant to the delivery of federal public policy functions. This would enable stakeholders and citizens to exercise a measure of oversight. However, most delegated arrangements are entities incorporated under the *Canada Corporations Act* or the *Canada Business Corporations Act*. They are not traded publicly and do not necessarily provide for public disclosure of corporate information. Indeed, traditional business practice is to guard information that is commercially confidential. Given the presence of federal purposes and of changing public attitudes, we expected to see transparency provisions at least as strong as those for access to federal information, and to see key information actively communicated to stakeholders and the public.

23.108 Among the delegated arrangements we examined, federal provisions for access to information apply only to the government's ongoing operational involvement in the Canadian Television Fund and the Canadian Adaptation and Rural Development Fund. Two arrangements — the Canadian Health Services Research Foundation and the Canada Foundation for Innovation — stated that they apply transparency policies similar to federal policy, but voluntarily and on a case-by-case basis. We were informed that citizens can gain access to corporate information held by sponsoring departments through access-to-information requests, but this process can be cumbersome. In our view this information should be more readily available, although we recognize that legitimate concerns about competitive business confidence and individual privacy may sometimes be limiting factors.

23.109 All of the delegated arrangements we examined have Web sites and disseminate some key information, including board decisions in some cases. We did not encounter any delegated

arrangements that make the minutes of board meetings available to the public. Boards that exercise federal authority or dispense federal funds might be expected to have these decisions open to public scrutiny.

23.110 When creating delegated arrangements, sponsoring departments should provide for reasonable standards of disclosure in the areas involving a federal public purpose; the standards should reflect public sector standards of access to information. Appropriate provision should be made for legitimate concerns of personal privacy and commercial confidence.

Some mechanisms to protect the public interest are present

23.111 Research conducted by EKOS Research Associates Inc. in 1998 found that 63 percent of Canadians favour the notion that "too much focus on private sector practices will weaken government's ability to protect the public interest." Canadians appear to recognize the need to protect the public interest in the exercise of government functions.

23.112 Complaint and redress mechanisms are often absent. When Canadians feel aggrieved by the decisions or actions of their governments, they can appeal for redress through their elected representatives. In delegated arrangements, independence from the government eliminates this avenue of appeal. In our opinion, an appeal mechanism short of litigation is needed for citizens affected by the discretionary decisions of bodies that exercise federal authority but are independent of federal control. There are a variety of ways to provide for redress. Of the delegated arrangements we examined, only The St. Lawrence Seaway Management Corporation has formal provisions for citizen redress. In the Canada Millennium Scholarship Foundation, provincial officials handle appeals after denial of a scholarship on financial grounds. The

other five arrangements make no provision for citizen redress.

23.113 Consultation is occurring. We expected to find that delegated arrangements consult widely with stakeholders and citizens. From our interviews, we found that all the delegated arrangements we examined consult with stakeholders to solicit information on changing client and stakeholder needs. Five of the seven have mechanisms for general public input.

23.114 Building public sector values into corporate culture. Canadians expect federal authority to be exercised with fairness, impartiality, equity, honesty, prudence and openness. They expect those who use federal authority to respect the public good and the rule of law, along with federal standards like providing services in English or French where demographics warrant, and values like personal privacy and cultural diversity. Four of the delegated arrangements we examined have formal provision for some public values as part of their operations. Two others manage the federal interest under values of peer review. Most of the arrangements have some federally appointed directors, or staff recruited from the public service, but this does not ensure that the arrangement will instil public sector values in the corporate culture or a sense of its public trust.

23.115 Private sector conflict-of-interest rules are not adequate. Canadians expect that those who exercise public authority will not abuse their power or influence. As a result, codes of ethical conduct and conflict of interest are more demanding in the public sector than the private sector. Private sector bodies that deliver public services to Canadians on behalf of the government need codes of conduct and conflict-of-interest rules that reflect public sector ethics. Two of the delegated arrangements we examined require that public sector rules on conflict

of interest be applied; two others apply public sector codes voluntarily.

23.116 Sponsoring departments should ensure that delegated arrangements include mechanisms to facilitate public consultation, make specific provision for relevant public sector values in the corporate culture, and establish appropriate mechanisms for redress of citizen complaints.

New Governance Arrangements Need Attention

Improvements can be made

23.117 We recognize that it is a challenge to adhere to the traditional principles of accountability while, at the same time, gaining flexibility through partnering agreements with other levels of government, the private sector or the voluntary sector. For example, in collaborative arrangements among government partners there are legislative mandates that may impose constraints, as well as political imperatives that must be recognized by those designing and implementing the new arrangement. In these cases, care is needed in co-ordinating the different components of the arrangement to ensure that the whole is well managed and able to report on the achievement of its objectives. If provincial governments are involved, their own accountability requirements come into play.

23.118 We recognize that since federal departments are active partners in collaborative arrangements, there is a link, attenuated though it may be, to parliamentary accountability and control through the responsible federal minister. Collaborative arrangements thus pose a lesser risk to accountability than delegated arrangements. For delegated arrangements, the *Canada Corporations Act* and the *Canada Business Corporations Act* are the usual legal structure and they provide for accountability only inside the corporation:

Collaborative arrangements pose a lesser risk to accountability than delegated arrangements.

management and staff are accountable to the board of directors, who are accountable to shareholders. In all but a few cases, delegated arrangements have weak accountability links to Parliament. As a result, significant amounts of federal authority and federal funds are currently beyond Parliament's scrutiny.

23.119 Trust and good will are essential and present, but are not enough. With the exception of the Canada Millennium Scholarship Foundation, which has encountered some political scrutiny, the arrangements we examined are working without drawing noticeable public attention or complaint. Several officials we interviewed attributed this to the competence, dedication and sense of public service exhibited by people currently involved in managing these arrangements, people both inside and outside the federal government. We note from our interviews, for example, that considerable attention has been paid to ensuring the appropriate professional competence and regional balance in the composition of boards for delegated arrangements. Enthusiasm, client good will and the determination of appointees to gain public confidence and to make the arrangements succeed, may offset weak accountability infrastructures in the short term, but alone cannot be counted on for success in the long term.

23.120 In the 17 new governance arrangements examined, we found numerous gaps and weaknesses in the design and implementation of their governing frameworks. As many of these arrangements are quite new and are expected to be in operation for many years, it would be worthwhile to correct these shortcomings. We recognize that bringing about such changes may not always be possible — given, for example, the need to consult with other levels of government and, in some cases, the independence of the other parties involved. Still, we expect that many of these parties would be interested in

improving their governing framework and associated practices. In most cases there will likely be occasions when the federal government can negotiate changes in the agreement that created the arrangement and the practices adopted to implement it.

23.121 Where existing new governance arrangements have inadequate provisions or practices for accountability and good governance, sponsoring departments should identify opportunities to negotiate appropriate improvements.

The nature of accountability is changing; good governance needs attention

23.122 Throughout this chapter, we have registered our concern that a consistent approach is needed to guide the creation of new governance arrangements so that essential elements of accountability and good governance are adequately addressed. In the more traditional delivery of federal objectives by departments, agencies and Crown corporations, there are clearly established — and indeed, legislated — governing frameworks in place. Once government steps outside these accountability and management regimes, it needs to take extra care to ensure that Parliament can maintain its role of scrutinizing federal actions and ensuring that the rights of citizens are protected. No one we interviewed questioned the general need for accountability to stakeholders, to the public, to sponsoring departments and/or to legislative bodies for expenditures of public moneys and the exercise of public authority.

23.123 A governing framework and discussion are needed. Governments in several other jurisdictions have set out such frameworks, thereby allowing their legislatures to decide how and to what extent they wish to scrutinize new ways of delivering government programs. Presenting a new and unique approach to Parliament with every proposed new

The government needs to take extra care to ensure that Parliament can maintain its role of scrutinizing federal actions and ensuring that the rights of citizens are protected.

arrangement — if presented at all — does not provide Parliament with the opportunity to fully consider and debate the merits of the approach. It does not enable Parliament to consider the essential question of reconciling diffused governance outside traditional government structures with accountability for the exercise of federal power.

23.124 Parliament may indeed decide to lessen its scrutiny of certain cases or classes of arrangements, perhaps in exchange for greater transparency and direct reporting to and involvement of the public. Or it may decide to change the focus of its scrutiny in some cases to focus on, for example, not how well public funds have been managed but to what extent federal objectives have been achieved. In our view, changing the nature of accountability to Parliament — as is happening with new governance arrangements — must be done only after considered thought and debate.

23.125 **The government should begin a process of consultation with Parliament and the public on how to reconcile new governance arrangements with accountability to Parliament and how to formalize the participation and accountability of independent parties involved in the achievement of federal objectives.**

Conclusion

23.126 Over the past decade, the government has increasingly worked with partners in the delivery of programs and services and, as shown by our survey, the federal financial commitment in collaborative and delegated arrangements is growing. Our discussions with some departmental officials suggest that this trend is likely to continue.

23.127 In the new governance arrangements we examined, most had gaps and weaknesses in their formal governing provisions and in the

implementation of those provisions. Accountability to Parliament was often weak and good governance not always assured.

23.128 Many of our observations point to weaknesses in the ad hoc approach taken by the government in creating new governance arrangements. We have noted the lack of a conscious effort to systematically consider the essential elements of reporting, accountability mechanisms, transparency and protection of the public interest when designing new arrangements. We believe that the use of a structured approach, based on a governing framework such as we have suggested and applied as appropriate, would guide departments in addressing the needs of Parliament and the public and still allow the federal government to create innovative and flexible arrangements with outside partners.

Changing the nature of accountability to Parliament must be done only after considered thought and debate.

Treasury Board Secretariat's response:
The Treasury Board Secretariat (TBS) supports the management framework and reporting principles outlined in the OAG's April 1999 Report (Chapter 5), which are described in detail in Exhibit 23.2. However, it is important to recognize that these new governance arrangements are, by their very nature, varied and cannot always adhere to a rigid framework. Indeed, the framework must be flexible to accommodate the diversity and complexity of these arrangements and to recognize that, implicitly, there must be some compromise between the exercise of direct control and the objectives of public policy, as was emphasized in the joint OAG/TBS paper, Modernizing Accountability Practices in the Public Sector. In fact, involving partners in the delivery of public services/programs requires negotiation and a flexible approach to risk management, as well as adequate accountability practices.

We recognize that these new arrangements must incorporate a management framework that enables those arrangements to achieve public interest

objectives, report to the public, be transparent and protect the public interest. TBS fully endorses these principles. Our efforts to modernize the role of TBS and to renew accountability practices are in keeping with these principles. It is our view that existing reporting mechanisms address to a large extent the concerns raised by the OAG. However, there are still a few areas for improvement. TBS has already undertaken several initiatives to improve the accountability framework. The current review of the Alternative Service Delivery framework will apply the federal government's new governance requirements to these new arrangements. Further, the future development of a Management Practices Guide and Database on practices to consider will make it easier to implement ASD initiatives and will enable TBS to develop policies based on expressed needs.

It is precisely in this context that the Treasury Board's role as a Management Board becomes important. TBS's mandate

is structured around its two main activities: providing informed advice to departments and policy development. TBS's role in supporting management board requires an emphasis on guidance based on the advanced principles of modern management. Specifically, other central agencies such as the Privy Council Office have worked closely with departments in addressing issues of ministerial accountability for inclusion in the enabling legislation for the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation.

The OAG raises the need to get parliamentary concurrence on the reporting and accountability needs for these arrangements. We will be proposing to Parliament the government's approach to such reporting as part of the second phase of the Improved Reporting to Parliament Project, as described in the government's fifth annual report, Managing For Results 1999.



About the Audit

Objectives

The objectives of the audit were:

- to determine the extent to which new governance arrangements are being used;
- to assess the adequacy of the accountability provisions and practice in selected new governance arrangements; and
- to assess the adequacy of guidance provided in the creation of new governance arrangements and subsequent monitoring of their implementation by central agencies and selected departments.

Scope

Our audit looked at new governance arrangements in all federal departments and agencies. In addition, we examined the accountability frameworks in a number of selected arrangements. Finally, we looked at the activities carried out by central agencies and sponsoring departments in establishing these new arrangements.

We excluded a number of types of arrangements that have several features of new governance arrangements but do not significantly challenge the traditional structure of ministerial accountability. Consequently, we did not include in our scope:

- reorganizations and innovations inside the federal government;
- contracting for goods and services, and other circumstances where an entity outside the federal government acts only as an agent or contractor;
- functions that the federal government has privatized to commercial markets or has devolved to other levels of government;
- Crown corporations, and
- arrangements involving the federal government and international partners.

We also excluded most arrangements of Environment Canada, since the Department has been involved in collaborative arrangements in areas of shared jurisdiction for many years. However, its experience in delivering selected programs with outside parties is valuable, and is described in Exhibit 23.7 of the chapter. In addition, we excluded arrangements that Indian and Northern Affairs Canada has in the area of self-government because this has been a long-standing government initiative and this Office is examining it in other audits.

We also excluded arrangements that were established before 1990. We recognize that several of the types of new governance arrangements of interest to us were not “new” and have been used by the federal government for many years.

Criteria

We assessed the case studies against three basic criteria:

There should be an appropriate accountability framework in place, that serves the public interest, including:

- clearly established expectations for the achievement of public objectives and expected accomplishments;
- clearly established roles and responsibilities of each partner;
- mechanisms for credible and timely reporting on performance;
- mechanisms for evaluation, review and adjustment; and
- mechanisms for protecting the public interest.

There should be adequate practices of accountability for federal involvement, including:

- understanding and agreement among parties on the key features of the accountability framework;
- credible reporting on performance by the arrangement and by the federal government;
- effective federal review and adjustment; and
- adequate transparency and attention to the public interest.

There should be appropriate central guidance on providing for adequate accountability and good governance in the design of new governance arrangements. As well, there should be central monitoring, compilation of lessons learned and communication of those lessons.

Approach

We conducted a survey of all federal government departments to identify new governance arrangements established since 1990 and to estimate the federal resources contributed to them. We selected a range of specific arrangements, examined relevant departmental and organizational documentation and conducted interviews with officials of the sponsoring departments (and in some cases its partners in arrangements), as well as central agencies. We concentrated on the design and implementation of new governance arrangements and their governing frameworks. We also reviewed literature on governance and accountability and drew from our work on collaborative arrangements (April 1999 Report of the Auditor General, Chapter 5).

Audit Team

Assistant Auditor General: Maria Barrados

Principal: John Mayne

Directors: Patricia MacDonald and Robert Cook

Allison Fader

Adèle Lamoureux

Christina Brooks

Thomas Cyopeck

For further information, please contact John Mayne.

Appendix A

Accountability Frameworks in Other Jurisdictions

The Canadian Voluntary Sector

The recently published report of the Panel on Accountability and Governance in the Voluntary Sector, commissioned by an unincorporated group of Canada's major national voluntary organizations and coalitions, strongly recommended greater accountability in non-profit bodies and charities that perform public functions. In the course of putting forward recommendations for improving governance and accountability in the sector, the report addressed the following elements:

Transparency in all governance practices, that is, establishing policies for communicating and receiving feedback from stakeholders; ensuring that the complaints and grievance procedure works effectively; holding regular board meetings that allow for discussion; ensuring that appropriate minutes and documents are kept; and responding appropriately to requests for information by the public, members or clients.

Annual, publicly available reporting to government on mission, programs and intended results; board-approved financial statements for fundraising activities; basic board governance structures and processes; the organization's code of ethical fundraising and its complaint response approach; and contacts for further information.

Larger organizations would also be required to provide information on how they fulfil the good practice guide's eight key tasks. This annual reporting would describe the entity's mission, intended outcomes and strategic planning processes; its policies for transparency, including code of ethical conduct and complaints process; its governing structures, including whether an independent nominating and audit committees exist; summary of the provisions for board stewardship; evidence of fiscal responsibility, for example, through provision of audited financial statements; and provisions for board succession and diversity of representation (if applicable).

Reporting that focusses on performance by building voluntary organizational capacity and recognition by funders of the need to focus on performance; identifying outcome goals; developing ways to measure progress and achievement of goals; collecting and analyzing the data; and disseminating outcome assessments to stakeholders and using them in planning.

Source: Panel on Accountability and Governance in the Voluntary Sector (Broadbent Panel), *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector - Final Report*, February 1999

Recommended Accountability Framework for Australasian Countries

The Australasian Council of Auditors-General, which includes the 13 Auditors General of Australia, New Zealand, Papua-New Guinea, Fiji and Hong Kong, has stated that an adequate accountability regime for public-private sector arrangements would need to include:

- legislative provisions requiring government to report to Parliament in a timely, regular way on issues relevant to Parliament's oversight role, likely including probity, compliance and performance issues (including financial audits) and other arrangement-specific reportable issues;
- requirement for the Auditor-General to test the assertions of management and to provide Parliament with the Auditor-General's opinion on the fairness and accuracy (on the basis of standards) of information provided by management to Parliament;
- provision for Auditors-General to advise Parliament publicly of matters identified in the audit process that Parliament should know about;
- parliamentary mechanisms of inquiry and, if necessary, censure; and

- parliamentary access to commercial documents to which the government is a party.

Source: Australasian Council of Auditors General, *Statement of Principles: Commercial Confidentiality and the Public Interest*, 1997, available on Web site <http://www.acag.org.au>

United Kingdom Practice Applicable to Accountability of New Governance Arrangements

As the result of a comprehensive review in 1997, the British government has further developed its principles for accountability of non-departmental public bodies, sometimes called QUANGOs (Quasi-Autonomous Non-Governmental Organizations). These are bodies that have a role in the processes of national government, but are not government departments. They work at arm's length from ministers and have a degree of independence (e.g. British Council, British Museum, Commonwealth Institute, etc.). The principles of accountability for those bodies include the following:

- Parliamentary committees should play a more systematic role in overseeing QUANGOs (e.g. scrutinizing annual reports and being involved in quinquennial reviews).
- QUANGOs are accountable to Parliament through Acts of Parliament, through the minister of the sponsor department, through the Public Accounts Committee and through relevant parliamentary committees.
- The Comptroller and Auditor General should have inspection rights over all public bodies that he does not audit directly.
- All public bodies should produce annual reports and make them publicly available in order to improve transparency.
- Where practicable, public bodies should hold meetings in public — perhaps by arranging an annual open meeting.
- Where practicable, public bodies should release summary reports of meetings.
- The proposed Freedom of Information Act is expected to cover all public bodies including non-departmental public bodies, allowing rights of access to information about and held by them, and including the rights of members of the public to see their own records. In the meantime, public bodies are required to make full use of the discretion available under the Code of Practice on Access to Government Information to disclose as much information as possible, including minutes of meetings.
- Government reporting on public bodies should include basic information about local public spending bodies that are not technically public bodies, such as training and enterprise councils, which are private sector companies limited by guarantee but which receive public funds.

Sources: Chancellor of the Duchy of Lancaster and the Financial Secretary to the Treasury, *Spending Public Money: Governance and Audit Issues*, March 1996, London, England.

Second Report of the Committee on Standards in Public Life (Nolan Report), *Standards in Public Life: Local Public Spending Bodies*, May 1996, London, England.

Fourth Report of the Committee on Standards in Public Life (Nolan Report), *Standards in Public Life: Review of Standards of Conduct in Executive NDPBs, NHS Trusts and Local Public Spending Bodies*, November 1997, London, England.

Cabinet Office, *Quangos: Opening the Doors*, UK, June 1998, available on Web site <http://www.open.gov.uk>

Appendix B

New Governance Arrangements Identified in OAG Survey

Part A: List of Collaborative Arrangements

Department/Agency	Collaborative Arrangements
Agriculture and Agri-Food Canada	Canada-Manitoba Partnership Agreement on Municipal Water Infrastructure (1990) Canada-Saskatchewan Partnership Agreement on Water-based Economic Development (1991) Programs under the Canadian Adaptation and Rural Development Fund – 7 programs (1992) * National Beef Industry Development Fund (1995) Safety Net Companion Programs - 15 programs (1996) *
Canada Economic Development for Quebec Regions	Info entrepreneur et Ressources Entreprises Inc. – two programs (1994) * Programs with shared authorities – three programs (1997) *
Canadian Food Inspection Agency	Canadian Animal Health Network (1997) Centre opérationnel du Québec (1998) Canadian Partnership for Consumer Food Safety Education (1998)
Canadian Heritage	National Sport Centres – 7 centres (1994) * Canadian Heritage Information Network (1995) Canada-Alberta Strategic Alliance on Culture and Heritage (1995) Young Canada Works – 5 components (1996) *
Citizenship and Immigration Canada	Centre for Canadian Language Benchmarks (1998)
Department of Fisheries and Oceans	Sablefish Quota Agreement (1992) Canada-Infomar Dealership Agreement (1993) Canada-NDI Agreement for Marketing and Distribution of Electronic Charts (1994; Revised 1998) Pacific Prawn Fishery – Co-management (1995) Pacific Shrimp Trawl Fishery Co-management (1997) Pacific Halibut Management Association (1999)
Department of Justice	Community Mobilization Program (1998)
Environment Canada	Canada-Wide Accord on Environmental Harmonization (1998) **
Health Canada	Health Transition Fund (1997)
Human Resources Development Canada	Labour Market Development Agreements – 11 agreements (1996) * <i>Canada-Alberta Labour Market Development Agreement (1996)</i> Regional Bilateral Agreements – 54 agreements (1996) * Employability Assistance for People with Disabilities (1998) National Child Benefit (1998) Canada Education Savings Grants (1998) Social Development Partnership Program (1998) Fisheries Early Retirement (Fisheries Restructuring and Adjustment Program) (1998)

* Involves a number of agreements or sub-agreements; dates refer to the first agreement or sub-agreement signed.

** Environment Canada has been involved in collaborative arrangements in areas of shared jurisdiction for many years. These arrangements have not been included in this survey. The experiences of Environment Canada are discussed in a box located in the section on the role of the central agencies. In addition, the survey has not covered the activities of Indian and Northern Affairs Canada in the area of self-government.

New governance arrangements created since 1990 and still in existence in March 1999.

Arrangements in **bold** are examined through case studies.

Department/Agency	Collaborative Arrangements
Industry Canada	Computers for Schools (1993) Canadian Tourism Commission <i>Product Club Program 1998</i> Canada Business Service Centres – 3 agreements (1995) *
National Defence	Emergency Preparedness Partners in Canada (1997) Canadian Emergency Preparedness Association (1999)
Natural Resources Canada	Canadian Industry Program for Energy Conservation (1992) Canada's Model Forests Program – 11 agreements (1992) * <i>Foothills Model Forest (1992)</i> National Centre for Upgrading Technology (1995) First Nations Forestry Program (1996) Wildlife Conservation in Resource Development Initiative (1997) *** Biodiversity Stewardship by Resource Industries Initiative (1999) Charge-up to Recycle Program! (1997)
Environment Canada	Climate Change Action Fund (1998)
Royal Canadian Mounted Police	RCMP Foundation (1995) E-COMM – Emergency Communications for South-West B.C. (1997)
Statistics Canada	Data Liberation Initiative (1996)
Treasury Board Secretariat	Canada Infrastructure Works Program – 12 agreements (1994) *
Veterans Affairs Canada and other departments	Knowledge Economy Partnership (1997)
Western Economic Diversification Canada	Collaborative Business Service Centres – 4 agreements (1993) * Loan Investment Fund Program – 15 programs (1995) *

* Involves a number of agreements or sub-agreements; dates refer to the first agreement or sub-agreement signed.

*** The Wildlife Conservation Resources Development Initiative ended in 1999 and was replaced at that time by the Biodiversity Stewardship by Resource Industries Initiative.

New governance arrangements created since 1990 and still in existence in March 1999.

Arrangements in **bold** are examined through case studies.

Part B: List of Delegated Arrangements

Department/Agency	Delegated Arrangements
Agriculture and Agri-Food Canada	Canadian Adaptation and Rural Development Fund – Provincial Councils – 13 councils (1995) *
Atlantic Canada Opportunities Agency	Young Entrepreneurs ConneXion Seed Capital and Counselling Program for Young Entrepreneurs (1997)
Canadian Food Inspection Agency	Canadian Beef Grading Agency (1996) Canadian Seed Institute (1998)
Canadian Heritage	Canadian Television Fund (1996) Aboriginal Friendship Centres Program (1996) Loan Program for Book Publishers (1998)
Citizenship and Immigration Canada	Canada-Quebec Accord Relating to Immigration and Temporary Admission of Aliens (1991) Canada-Manitoba Agreement to Realign Responsibilities for Immigrant Settlement Services (1998) Agreement for Canada-British Columbia Co-operation on Immigration – Realignment of Responsibilities for Immigrant Settlement Services (1998)
Department of Fisheries and Oceans	Pacific Salmon Conservation, Enhancement and Restoration Program (1995) Marine Oil Spill Preparedness and Response Regime (1995)
Department of Foreign Affairs and International Trade	Canadian Centre for Foreign Policy Development (1996)
Health Canada Medical Research Council	Canadian Health Services Research Foundation (1997)
Human Resources Development Canada	Canada Millennium Scholarship Foundation (1998)
Indian and Northern Affairs Canada**	Mi'Kmaq Sectoral Education Self-Government (1997) Aboriginal Healing Foundation (1998)
Industry Canada	Canadian Network for the Advancement of Research, Industry and Education (1993) Canada Foundation for Innovation (1997)
Social Sciences and Humanities Research Council, Natural Sciences and Engineering Research Council	Network of Centres of Excellence Program (1990)
Transport Canada	Canadian Airports Authorities – 26 airports (1992) * Blainville Test Centre (1996)
	The St. Lawrence Seaway Management Corporation (1998) Canada Port Authority – 18 ports (1999) *
Western Economic Diversification Canada	Women's Enterprise Initiative – 4 agreements (1994) * Service Delivery Network Program – 9 programs (1995) *

* Involves a number of agreements or sub-agreements; dates refer to the first agreement or sub-agreement signed.

** Environment Canada has been involved in collaborative arrangements in areas of shared jurisdiction for many years. These arrangements have not been included in this survey. The experiences of Environment Canada are discussed in a box located in the section on the role of the central agencies. In addition, the survey has not covered the activities of Indian and Northern Affairs Canada in the area of self-government.

New governance arrangements created since 1990 and still in existence in March 1999.
Arrangements in **bold** are examined through case studies.

Appendix C

Collaborative Arrangements Examined in the Audit

Collaborative Arrangement	Description/Purpose	Federal Departments Involved	Partners	Federal Funding	Other Contributions
Canada's Model Forests Program (Foothills Model Forest) Established 1992 (Phase 2 started 1997)	Foothills Model Forest is one of 11 Model Forest Groups in a national program created to work in partnerships to enhance forest management at the local level, transfer knowledge, and demonstrate management approaches that are based on principles of sustainable development.	Natural Resources Canada Provincial and municipal governments, industry, educational institutions, and other interest groups	\$2.5 million for Foothills Model Forest (1997–2002) ¹ (Federal commitment for the program as a whole is \$96m between 1997 and 2002) ²	\$10 million for Foothills Model Forest (1997–2002) ¹ (Partner commitment for the program as a whole is \$13.7m between 1997 and 2002) ²	
Canada-Alberta Labour Market Development Agreement Established 1996	One of several bilateral arrangements established to provide for a stronger provincial role in the design and delivery of labour market development programs and services.	Human Resources Development Canada	Provincial government	\$314.2 million (1997–98 to 1999–00) ¹	Unknown
Canada Infrastructure Works Program Established 1994 (Phase 2 started 1997)	An arrangement between the federal and provincial or territorial governments designed to renew and enhance physical infrastructure, particularly in local communities, and to promote job creation and skills development.	Treasury Board Secretariat, Industry Canada, Atlantic Canada Opportunities Agency, Western Economic Diversification Canada, Economic Development Agency for the Region of Quebec, Indian and Northern Affairs Canada	Provincial and territorial governments	\$2.4 billion (1994–95 to 1999/00) ³	\$5.9 billion (1994–95 to 1999–00) ¹
Canada-Wide Accord on Environmental Harmonization Established 1998	A framework agreement aimed at harmonizing environmental programs and policies through Canada-wide co-ordinated action with the provinces and territories, by guiding the development of sub-agreements in specific areas. Sub-agreements have been negotiated in areas such as environmental inspection, environmental assessment and Canada-wide standards.	Environment Canada	Provincial and territorial governments (excluding Quebec)	None ¹	None ¹

Collaborative Arrangement	Description/Purpose	Federal Departments Involved	Partners	Federal Funding	Other Contributions
Canadian Industry Program for Energy Conservation Established 1992 (CIPEC, Phase 3 started 1997)	A voluntary initiative of Canada's manufacturing and mining industries that promotes the reduction of industrial energy use per unit of production while participating in other efforts to meet Canada's carbon dioxide stabilization objectives.	Natural Resources Canada	Industry groups and private sector	None ¹	None ¹
Canadian Tourism Commission – Product Club Program (Quebec) Established 1998	A national program undertaken by tourism consortia to create tourism products aimed at bringing together small and medium-sized businesses to pool knowledge, efforts and resources to extend the range of market-ready products.	Industry Canada (Canadian Tourism Commission)	Provincial and territorial governments, private sector, industry other interest groups	\$ 0.8 million (1997-98) ¹	\$ 1.3 million (1997-98) ¹
Loan Investment Fund Program Established 1995	A program that guarantees repayment of loans to small and medium-sized enterprises by partner financial institutions.	Western Economic Diversification Canada	Banks, lending institutions	\$ 57.4 million contingent liability (1995-2007) ²	(\$139 million repayable loans) ²
National Child Benefit Established 1998	An initiative that provides enhanced federal child benefits for low-income families as well as increased provincial, territorial and First Nations reinvestments in services and benefits for these families.	Human Resources Development Canada, Indian Revenue Canada, Indian and Northern Affairs Canada	Provincial and territorial governments (excluding Quebec)	\$3.8 billion between 1998-99 and 2000-2001, and \$1.7 billion ongoing thereafter ¹	\$805 million ⁴ (1998-99 to 1999-00) ¹
Employability Assistance for People with Disabilities Established 1998	An arrangement that provides for provinces to deliver a range of services aimed at integrating people with disabilities into the labour force. Funding is shared equally by both federal and provincial/territorial governments.	Human Resources Development Canada	Provincial and territorial governments	\$965 million (1998-99 to 2002-03) ¹	\$960 million (1998-99 to 2002-03) ¹
Health Transition Fund Established 1997	An arrangement to encourage innovations leading to a more integrated health care system by supporting pilot and evaluation projects in four priority areas: home care, pharmacare, primary care and integrated service delivery.	Health Canada	Provincial and territorial governments	None ¹	None ¹

Notes: 1 Arrangement documentation, interviews with program officials

2 Office of the Auditor General, Survey of New Governance Arrangements

3 Reported in Auditor General's 1999 Report, Chapter 17

4 Most of this amount represents savings reinvested in other related programs.

Appendix D

Delegated Arrangements Examined in the Audit

Delegated Arrangement	Description/Purpose	Federal Departments Involved	Federal Funding	Other Contributions
Canadian Adaptation and Rural Development Fund – Provincial councils Established 1995 (Phase 2 started 1999)	A program intended to increase the agricultural industry's ability to adapt and become more self-reliant in a changing environment.	Agriculture and Agri-Food Canada	\$25 million annually (1995–96 to 2000–01) ¹	None ²
Canada Millennium Scholarship Foundation Established 1998	An independent body created through the <i>Budget Implementation Act</i> of 1998 to manage a federal endowment. It will grant some 100,000 scholarships each year for the next decade.	Human Resources Development Canada, Department of Finance	\$2,500 million (1997–98 to 2009–10) ¹	None ¹
Canada Foundation for Innovation Established 1997	An independent, not-for-profit corporation created under the <i>Budget Implementation Act</i> 1997 to provide funding to universities, colleges, hospitals and other not-for-profit institutions to obtain necessary research infrastructure.	Industry Canada, Department of Finance	\$1,000 million (1996–97 to 2002–03) ¹	\$1,500 million in leveraged funding from other sources (1996–97 to 2002–03) ¹
Canadian Health Services Research Foundation Established 1997	A partnership of public and private health sector stakeholders that operates as an independent, arm's-length, non-profit corporation to fund research in health services management and systems.	Health Canada (Medical Research Council, Social Sciences and Humanities Research Council)	\$65 million ¹	None ¹
Canadian Television Fund Established 1996	An independent not-for-profit corporation mandated to support Canadian television and film industry production. It replaces the Canadian Cable Production Fund.	Canadian Heritage	\$500 million (1996–97 to 2000–01) ¹	\$500 million (1996–97 to 2000–01) ¹
The St. Lawrence Seaway Management Corporation Established 1998	An independent corporation responsible for the management, operation, and maintenance of the St. Lawrence Seaway. It replaces the St. Lawrence Seaway Authority, a Crown corporation.	Transport Canada	\$83 million (1998–99 to 2000–01) ¹	\$36 million non-interest bearing promissory note payable on termination of management agreement ¹

Delegated Arrangement	Description/Purpose	Federal Departments Involved	Federal Funding	Other Contributions
Borderline Arrangement: Canadian Institute for Health Information Established 1994	An independent, not-for-profit corporation given responsibility for developing and maintaining Canada's health statistics information system, in support of policy, health system management and public awareness.	Health Canada Statistics Canada	\$110.6 million (including a one-time grant of \$95 million from Health Canada (1994-1999) ²)	\$10.5 million (1994-1999) ²

Notes: 1 Arrangement documentation, interviews with program officials

2 Office of the Auditor General Survey of New Governance Arrangements

Chapter 24

**The Canadian Adaptation and
Rural Development Fund**

**An Example of Involving
Others in Governing**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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The Canadian Adaptation and Rural Development Fund

An Example of Involving Others in Governing

Main Points

- 24.1** The Canadian Adaptation and Rural Development (CARD) fund is a new governance arrangement developed by Agriculture and Agri-Food Canada to help farmers, producers and processors adapt to the new business realities of farming. Under the arrangement, projects to support agricultural adaptation are selected largely by the agriculture industry for funding.
- 24.2** We found that a reasonable balance had been struck between giving industry councils the freedom to make the best decisions and respecting the public purpose of the funds. In designing this arrangement, the Department developed a number of good practices. However, we also found some areas that need to be improved.
- 24.3** In conjunction with the Department, we developed an instrument to assess the capabilities of the adaptation councils. Pilot results suggest that the CARD councils rate well in most of the required competencies. We determined that the instrument could be useful for assessing the capabilities of parties in this new governance arrangement and perhaps in others.

The Department accepts our findings and has committed to act on our recommendations, although no details have been provided.

Introduction

24.4 The business environment for farming has changed dramatically over the last several decades. The industry has had to adapt to reductions in government subsidies, changes in technology, growing concern about the environment, more competitive global markets, the decline of the rural population and other changes. In 1995, Agriculture and Agri-Food Canada introduced a strategy to assist in this adaptation, the Canadian Adaptation and Rural Development Strategy.

24.5 This strategy was designed to foster a growing, diversified, competitive sector and a healthy rural economy, and to help offset the impact of eliminating transportation support and reducing safety net subsidies. Further, in delivering this strategy the Department wished to design a package of programs that would respond to the government's objectives of bringing decision making closer to citizens, making government more cost-effective and involving the sector more directly in funding decisions. To pay for these programs, the Canadian Adaptation and Rural Development (CARD) fund was created.

24.6 Federal funds for the four-year CARD fund, about \$60 million annually, are shared between national and provincial applications. National programs receive \$35 million annually, while an annual allocation of \$25 million is administered by 13 provincial councils. National programs support initiatives that have potential benefits for Canadians in any province, while provincial councils support initiatives that are unique to specific regions and have been identified as priorities by those regions.

24.7 Each province has a council that represents the agriculture and agri-food industry. Funding for the councils is provided by federal grant. Council members in each province are representatives of the industry, and

include producers and agri-food processors in the province. Members of the council are selected either by industry vote or by federal appointment, depending on the province. The size of the council also varies by province. Both the federal and provincial governments are represented on the councils but do not have a vote. The federal government largely guided the design and development of the councils. Resources for administration are covered by the grants to the councils, although in some provinces the provincial government has contributed resources.

24.8 CARD is a delegated arrangement. Agriculture and Agri-Food Canada has delegated extensive decision-making authority to each council to determine where CARD funding should be directed to best serve the adaptation needs in its province. Councils decide on everything from strategic funding priorities (within policy bounds set by Agriculture and Agri-Food Canada) to approval of individual applications for project funding from CARD funds.

24.9 Representatives of the agri-food industry with an adaptation project can apply to the provincial council for funding of the project. The following are a few examples of the hundreds of projects partially funded within the adaptation priorities of this program:

- **Human resource development.** Youth conferences (for example, 4H); farm safety education (such as farm safety pamphlets for schools); and farm management conferences and skills training (conference on abandonment of rail lines, use of computer technology to improve operations, evaluation of value-added opportunities, leadership, management and strategic visioning).

- **Research and development.** Disease-resistant seed and more economical feed.

- **Infrastructure support.** Understanding and communicating

Councils decide on everything from strategic funding priorities to approval of individual applications for project funding.

For the most part, we found that the controls the Department has developed for the arrangement were appropriate to ensure an adequate governing framework.

benefits of and barriers to sustainable cropping practices.

- **Enhanced access to capital.** Funding of business plans and market feasibility studies.
- **Improved market information and utilization.** New products, including fruit chips, byproducts, organic products, and hemp oil.

24.10 Approval was given for the second phase of CARD, known as CARD II, beginning 1 April 1999. Annual funding will continue at \$60 million. Further, the government has approved CARD as an ongoing program of the Department.

Evolution and design of industry councils

24.11 Agriculture and Agri-Food Canada considers the use of industry councils to be an important innovation in its delivery of adaptation programs. A number of factors led to its decision to experiment with using them to provide programs. At the time that CARD was created, the government of the day was particularly interested in alternative ways to make decisions. This program allowed industry to decide how it could best be helped to adapt to change. The Department hoped this would result in better decisions and would increase the

support and involvement of industry. As well, giving industry more responsibility for decisions reflected the program's objective of increasing industry's ability to adapt and become more self-reliant.

24.12 Exhibit 24.1 summarizes some of the comments made by the Minister and the provincial council chairs about the creation of the councils.

24.13 The councils are using public funds that have a specific public purpose. Although the Minister of Agriculture remains accountable to Parliament for the expenditure of these funds, there are no conditions attached to them because they are in the form of grants. The Department recognized the importance of providing for accountability mechanisms, so it developed a number of objectives, principles, guidelines and criteria that the councils are required to respect and include in their by-laws. The Department also developed a performance management framework that the councils are required to use to measure and report on their performance.

Focus of the audit

24.14 This audit focussed on the mechanisms the Department included in the design and development of the provincial councils to ensure adequate accountability and control of federal funds. We conducted our examination at Agriculture and Agri-Food Canada and at three of the provincial councils. Specifically, we examined the framework governing arrangements between the federal government and the provincial councils.

Observations and Recommendations

24.15 For the most part, we found that the controls the Department has developed for the arrangement were appropriate to ensure an adequate governing framework. Those that we consider good practices are

Exhibit 24.1

Minister's and Provincial Council Chairs' Comments

What the Minister said: "I am pleased that industry groups have so enthusiastically pooled their expertise and experience to form these councils. This groundbreaking initiative demonstrates how producer organizations are determined to take charge of their future and to build a more innovative and prosperous rural economy."

What two councils said: "This council represents a unique partnership based on the belief that farm and rural organizations have the knowledge and ability to help determine the most effective allocation of government funds."

"The council was established by all rural industry players to facilitate adaptation to the new realities and challenges ahead, thereby fostering a dynamic approach within agriculture in the province."

summarized in Exhibit 24.2. Some of the gaps in reporting, accountability mechanisms, transparency and protection of the public interest noted in Chapter 23 (paragraphs 23.85 through 23.116) we also noted in CARD; for example, the Department has not required specific provisions for conflict-of-interest codes, public service values and citizen redress mechanisms. These weaknesses are mitigated to some extent by the practices noted in Exhibit 24.2.

Councils require more guidance

24.16 Guidance from the Department could be improved to ensure better and more consistent decision making across councils. Guidance does not mean more control and it does not need to be prescriptive. The kind of guidance the councils need could include the logic underlying the objectives, principles, guidelines and criteria the Department has established, or more detailed definitions that support them. For example, “normal commercial operations” cannot be funded under CARD. Some councils have had difficulty identifying what this term was intended to mean. More guidance from the Department on the logic behind this restriction would help to ensure that interpretation is consistent. Providing information on best practices and encouraging greater sharing of information and learning among councils could also be a way for the Department to help the councils operate effectively and efficiently. This sharing would allow councils to capitalize on the experience of the Department and other councils, rather than “reinventing the wheel” each time there is an operational challenge. For example, sharing the lessons learned from using royalties and loan guarantees as a means for a council to provide funding to a project would help those councils that have no experience using such arrangements. Council members confirmed the desire for more guidance and greater sharing of this kind.

24.17 Agriculture and Agri-Food Canada should provide further guidance to the councils, in particular by defining and presenting the logic underlying the objectives, principles, guidelines and criteria established by the Department. It should also work with the councils to develop better means of sharing experience and good practices.

The next step in performance management is better public and parliamentary reporting

24.18 The Department requires the councils to report annually on the performance of funded projects in accordance with the CARD performance management framework. Using the results of this reporting, the Department completes a central aggregation of performance management data in a national project database. While the Department has reported some performance information on CARD in the Departmental Performance Report, it has yet to make extensive use of the performance information gathered as part of the performance management framework. The challenge will be to summarize this concisely in the Departmental Performance Report with references to where more detailed performance information can be found.

Guidance from the Department could be improved to ensure better and more consistent decision making across councils.

- Involvement of federal ex officio member on provincial councils
- Eligibility requirement that councils incorporate the objectives, principles, guidelines and criteria of the government into the council by-laws
- Requirement for councils to annually report on performance of funded projects in accordance with the Department's performance management framework
- Central aggregation of performance management data in a national project database

Exhibit 24.2

Good Practices

It is important that both the Department and the councils consider long-term strategies.

24.19 The Department should implement better means of ensuring that parliamentarians and the public have access to performance information collected by the program.

Strategy needed for long-term relationship with councils

24.20 Due to the experimental nature of these councils, original funding was limited to four years and the government's approval would be required for continuation of the program. Recently, the government approved a second phase of CARD that establishes it as an ongoing program of the Department. This makes it important that both the Department and the councils consider long-term strategies. Since there could be economies of scale if

the use of the councils were expanded, the Department may want to assess the merits of using the councils to administer other departmental programs. Conversely, the councils may want to attract other sources of funding. In these circumstances, it is important that both parties agree on the nature of the relationship between them. At the present time, there is no formal agreement on whether councils can continue to be eligible for funding from CARD if they arrange for funding from other sources. Nor is there any formal agreement on how disputes will be settled on this or any other issue.

24.21 The Department should consider and formalize a long-term strategy for its relationship with councils, including considering the

Exhibit 24.3

Assessing the Capabilities of a New Governance Arrangement

Agriculture and Agri-Food Canada has been using informal means to assess the capabilities of the Canadian Adaptation and Rural Development (CARD) councils. A departmental official assigned to each council attends council meetings as an ex officio, non-voting member. These officials have been able to form first-hand impressions of the strengths and weaknesses of their councils, but their impressions have not usually been captured and reported.

In conjunction with Agriculture and Agri-Food Canada, we developed an instrument for assessing the capabilities of adaptation councils. We did this to determine whether a more systematic process could prove to be a useful tool for monitoring this new governance arrangement and potentially others. The tool was then piloted with three of the councils.

Capabilities assessment tools are useful in the monitoring of new governance arrangements

Councils that took part in the pilot found the capability assessment tool to be useful. They reported that the results painted an accurate picture of the strengths and weaknesses of their councils. Some took immediate action to strengthen areas the assessment identified as needing improvement. Several councils that were not part of the pilot project have expressed an interest in using the tool.

We concluded that the tool could be used in other new governance arrangements, with minimal modification. Although this tool appears to be a valid and reliable means of assessing council capabilities, it is possible that other, superior tools could be developed. The capability model could be used in a variety of ways. It could reflect perceptions only, or be augmented by gathering corroborative evidence. It could be used by auditors or other external assessors, or the assessments could be completed by the federal government's partners in new governance arrangements and reported to the federal government. In the latter case, the credibility of the report could be enhanced by having a third party attest to the fairness of the information. As another alternative, assessments using the tool could be completed by the federal ex officio members of the councils alone and the results used internally by the government. And finally, by having users of the program complete parts of the assessment, this tool could be used to measure the extent to which the existing capabilities allow the council structure to meet the users' needs.

Because the success of new governance arrangements depends heavily on the capabilities of partners outside the federal government, capability assessments have a potentially valuable role. Knowledge of the capabilities of an outside organization should be a key consideration in deciding whether to involve it in a new governance arrangement and whether to continue that involvement thereafter. This information can equally help these organizations, by diagnosing strengths and weaknesses, to improve their capabilities and improve the success of their arrangements with the federal government.

merits of using the councils to deliver other programs.

Assessment tool results suggest good governance

24.22 The councils have been given considerable responsibility for decision making. Because the success of this program depends greatly on the councils' capabilities, it is important that they be assessed regularly. At the start of our audit, the Department had not developed a formal means to do this.

24.23 We undertook a project, in conjunction with the Department, to develop an instrument for assessing the capabilities of the councils (see Exhibit 24.3). For this project, 18 specific competencies required of CARD councils were identified. Questions were developed on each of the 18 required competencies to determine whether they were present in each council.

24.24 The completed capabilities assessment tool was then piloted in three CARD councils that volunteered for the pilot. Information was gathered through individual interviews with council members, council staff and federal ex officio members. The results were compiled and the capabilities of the three pilot CARD councils were compared with research data gathered by the Conference Board of Canada over several decades on the capabilities of private and public sector boards of directors. Because participants answered the questions from their own experience, the results reflect perceptions only.

24.25 Pilot assessment results suggest that CARD councils are generally strong, with some areas that need improvement. Members view their councils as generally well governed. Federal ex officio members and the councils' staffs essentially concur in the assessment of the strengths of the councils overall, with some modest differences of opinion on specific strengths and weaknesses.

24.26 There was considerable similarity among councils in their capabilities. They demonstrated strong performance in 8 of the 18 capabilities, rated fairly well in another 7, and would benefit from improvement in 3 others (see Exhibit 24.4). Further, given that the CARD councils were created quite recently, they compared favourably with established benchmarks for Canadian private and public sector boards of directors.

24.27 The results of the project suggest that the Department could find this or a similar tool useful in regularly assessing council capabilities.

24.28 The Department should incorporate the use of a capabilities assessment tool in its monitoring of program delivery by Canadian Adaptation and Rural Development councils.

The results of applying the assessment tool suggest that the Department could find this or a similar tool useful in regularly assessing council capabilities.

Conclusion

24.29 Notwithstanding the concerns noted above, we found that a reasonable balance has been struck between giving the industry councils freedom to make the best decisions and respecting the public purpose of the funds. The refinements to the program that we have recommended, and the recommendations in Chapter 23 that apply to all new governance arrangements, would provide additional comfort to the Department in its accountability role and should help to ensure the long-term success of the arrangements. It is important that the Department be cognizant of any additional administrative burden they might add.

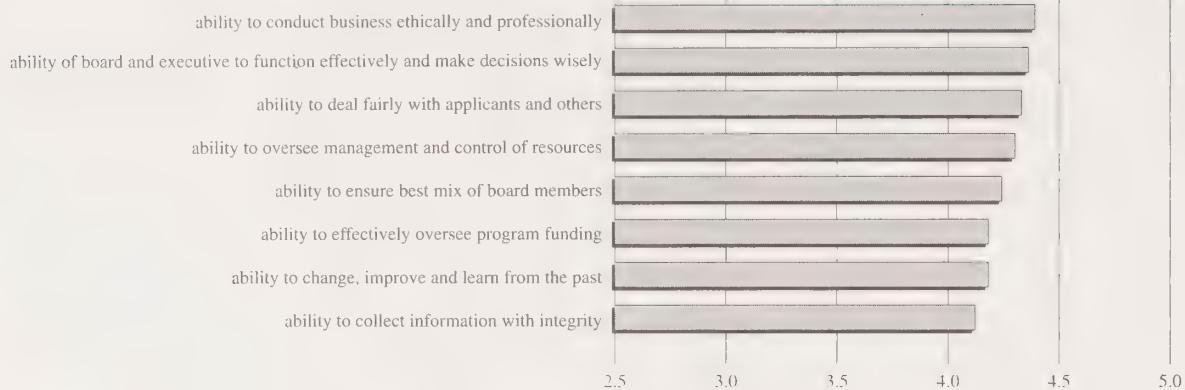
24.30 Results of the capability assessment indicate that there is a great deal of competence and enthusiasm within the councils. The success of this program can, in part, be attributed to these factors. However, it is possible that once the excitement surrounding the program begins to wane, the momentum of success will also wane. Where interpretation of federal requirements is needed, councils

The Canadian Adaptation and Rural Development Fund: An Example of Involving Others in Governing

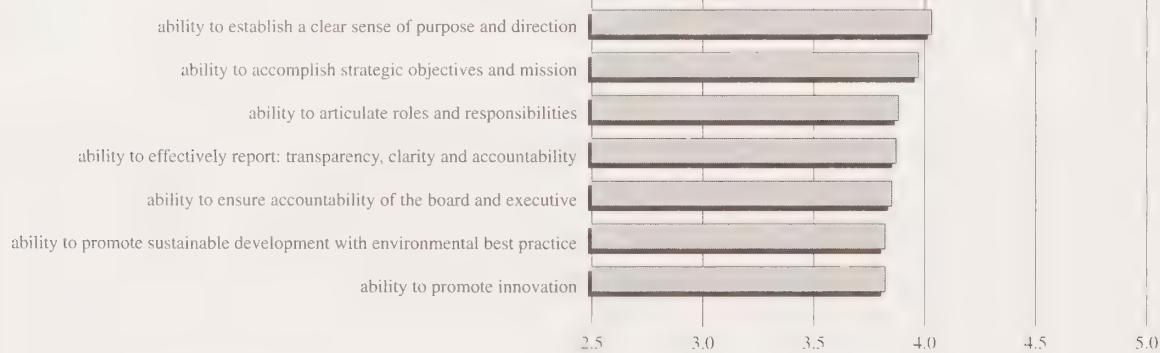
Exhibit 24.4

Key Findings About Council Capabilities Through Interviews

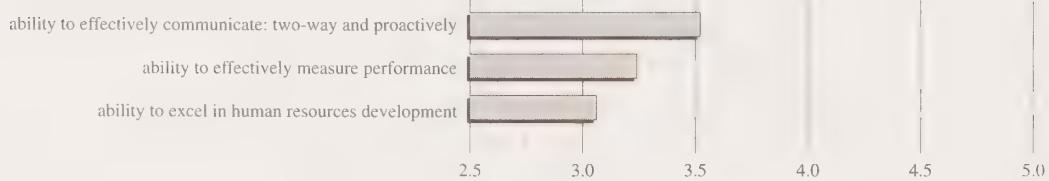
Council boards are perceived to exhibit the most strength in:



Council boards are perceived to rate fairly well in:



Council boards would benefit from improvements in:



Mean score of all respondents on questions related to each of the above capabilities, using the following scale:

- 0 – Not at all; nothing being done in this area
- 1 – Not well; improvement definitely needed
- 2 – Somewhat; improvement required
- 3 – Moderately well; satisfactory
- 4 – Quite well
- 5 – Very well; no improvement required

have been careful to ensure that they err on the side of the federal government. Over time, this could change. For this reason, it is important that the tools and guidance provided by the Department be adequate to support continued success.

Department's response: *The Department is proud of the CARD program and pleased that the Auditor General recognizes, in this separate chapter, the*

valuable contribution of the provincial councils and the good practices that contribute to this successful arrangement. We welcome the Auditor General's suggested refinements and will address them in our continuing efforts to improve this worthwhile initiative. We would also like to thank the councils who participated in the audit for their valuable contribution.



About the Audit

Objective

The objective of this audit was to assess the adequacy of the accountability and control arrangements established by Agriculture and Agri-Food Canada for provincial adaptation councils with whom it has arrangements for the delivery of the Canadian Adaptation and Rural Development (CARD) fund.

Scope

Our audit focussed on Agriculture and Agri-Food Canada, which designed the governing framework of the provincial adaptation councils that deliver CARD programming. While our Office did some work on the councils, as entities independent of the federal government they were not subject to our audit.

In parallel with the audit, this Office and Agriculture and Agri-Food Canada established a study project to develop and pilot a tool for assessing the capabilities of the provincial adaptation councils.

Criteria

In addition to the criteria for the audit of new governance arrangements in Chapter 23, Involving Others in Governing, one separate criterion was applied. Namely, we expected that the Department would provide guidance and direction to the councils to ensure that objectives are met.

Audit Team

Assistant Auditor General: Don Young

Principal: Neil Maxwell

Linda Anglin

Anthony Levita

Christian Weber

For more information, please contact Neil Maxwell.

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 25
Preparedness for Year 2000:
Final Preparation

November 1999

Report of the
Auditor General
of Canada
to the House of Commons

Chapter 25
Preparedness for Year 2000:
Final Preparation

November 1999

This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 25

Preparedness for Year 2000

Final Preparation

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Preparedness for Year 2000

Final Preparation

Main Points

25.1 The government has made significant progress in preparing its systems that support government-wide mission-critical functions for the Year 2000 computer problem. The Treasury Board Secretariat reported that work on government-wide mission-critical systems was 99 percent complete at July 1999. Our audit supports the overall 99 percent completion rate for those systems. According to its plans, all government-wide mission-critical systems were to be ready for Year 2000 by 31 October 1999, two months before the new millennium.

25.2 Health Canada and the Atomic Energy Control Board have established Year 2000 requirements for licensees of medical devices, nuclear power reactors and radioactive devices. Some follow-up is needed for medical and radioactive devices but the licensees for active nuclear power plants have met the requirements.

25.3 Measures are being put in place for contingencies and national emergencies. Although contingency procedures have largely been defined, departmental contingency planning needs more work.

25.4 We concluded that the government needs to remain vigilant to keep any Year 2000 disruptions to a minimum.

Background and other observations

25.5 Year 2000, the two-digit year code problem, has been a cause of concern to industry and governments around the world. The estimated costs of addressing this problem run as high as US\$800 billion worldwide. In August 1999, the federal government estimated the costs of its Year 2000 projects at \$2.2 billion. According to the Treasury Board Secretariat, the final costs could reach \$2.5 billion.

25.6 In 1997 we audited the government's preparedness for Year 2000, and again in 1998. Our 1997 Report noted our concern about the slow pace of Year 2000 work; in 1998, we remained very concerned that some essential services might be interrupted in 2000. Most of our recommendations have been accepted and implemented by the government.

25.7 In 1999, as we completed our work in individual departments and agencies, we reported our findings to management and suggested actions to consider. That additional step was taken to provide more time for departments and agencies to act.

25.8 We verified the government's Year 2000 progress information as reported by the Secretariat against the information in its supporting files and we further reviewed departmental documents for seven government-wide mission-critical functions in six organizations. Our verification showed no substantive differences from the information reported by the Secretariat.

25.9 In the departmental contingency plans we reviewed, we found that some key components were not complete or lacked specific details. In particular, plans for testing were weak and few organizations planned to complement the National Contingency Planning Group validation exercise with other tests of their contingency procedures.

25.10 We have identified several issues that will require action beyond 1999, and have recommended measures for the government to take or to consider. They include moving to comply with government date standards; maintaining and updating valuable information bases developed from Year 2000 projects; and looking out for Year 2000 pitfalls after January 2000.

The government's responses to our recommendations are included in the chapter. The government agrees with our recommendations and the responses identify the action that it will take to address them.

Introduction

25.11 The Year 2000 computer problem, often called the millennium bug or Y2K, refers to the potential for systems error, malfunction or failure caused by the past practice of representing the year with a two-digit code. Given the ever-increasing reliance on information technology, the Year 2000 threat extends to virtually all organizations in both the private and the public sectors around the world.

25.12 Because of the significance of its potential impact, we conducted two previous audits of the federal government's preparedness for Year 2000. In 1997, we audited the government's overall state of preparedness; in 1998, we focussed on the preparedness of systems that support government-wide mission-critical (GWMC) functions. The GWMC systems are those that the government considers essential to the health, safety, security and economic well-being of Canadians.

25.13 In our October 1997 Report, we were concerned about the pace of remediation work and the serious threat of Year 2000 to essential programs and services. In December 1998 we reported that while the pace of Year 2000 work had accelerated, the threat to some GWMC functions remained.

25.14 In that second Report, we recommended that Year 2000 continue to be a top priority for the government and that the related work be further accelerated. We emphasized the need for contingency planning and for the testing of those plans. We also encouraged the government to improve its government-wide monitoring of Year 2000 progress and its reporting of that progress to Parliament.

25.15 In 1997, when we started our Year 2000 audits, there had been few media reports on the subject. Many organizations, including some government

departments and agencies, had not proceeded much beyond the planning and inventory phase of their Year 2000 projects. At that time, one information technology research firm had estimated that the costs of addressing Year 2000 could reach US\$600 billion worldwide.

25.16 Thus far in 1999, the millennium bug has received widespread attention by the media and the level of public awareness in Canada and the United States has been high. Banks and utility companies have been reporting readiness and providing assurance to their customers. Estimates of Year 2000 costs worldwide now reach over US\$800 billion. The federal government's 1997 estimate of \$1 billion for Year 2000 costs was revised to \$2.2 billion in August 1999. The Treasury Board Secretariat has advised us that overall costs of Year 2000, including contingency planning and measures, could approach \$2.5 billion.

25.17 In 1999, the priority for most organizations has been to complete their final preparation for Year 2000.

Focus of the audit

25.18 Our current audit focussed on the government's final preparation for Year 2000. In particular, we audited three areas — readiness through government-wide monitoring and reporting of progress in GWMC systems and contingency planning; regulatory responsibilities; and national emergency preparedness.

25.19 To examine the government's readiness, we interviewed staff and reviewed files at the Treasury Board Secretariat and at six organizations that are responsible for seven government-wide mission-critical functions. We did not audit the readiness of departmental mission-critical systems. We selected two areas of regulatory responsibilities — medical devices at Health Canada and nuclear facilities and radioactive devices at the Atomic Energy Control Board. With respect to national emergency

The overall costs of Year 2000 for the government, including contingency planning and measures, could approach \$2.5 billion.

At July 1999, the overall completion index for systems supporting government-wide mission-critical functions was 99 percent.

preparedness, we audited the National Contingency Planning Group and Operation Abacus at National Defence.

25.20 Our audit work was not designed to provide assurance that the government will be able to deliver all mission-critical functions in 2000. The government remains responsible for its systems and their ability to continue to function properly beyond 1999. The purpose of this chapter is to provide information on the action that the government has taken to address Year 2000 and the observations we made during the audit. Further information about the audit objectives, scope and criteria can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

Government Readiness

Significant progress has been made in preparing government-wide mission-critical systems

25.21 In 1996, the Treasury Board Secretariat established a Year 2000 Project Office under its Chief Information Officer Branch to provide leadership in addressing Year 2000 issues in government. As we concluded our 1997 audit, the Secretariat advised us that it planned to monitor the Year 2000 progress of critical systems across the government. In the fall of 1997, it established a list of functions that were considered mission-critical across the government and began to request regular information on progress from the departments and agencies responsible for those functions.

25.22 The Secretariat adapted the methodology of a large information technology research and consulting firm. It set target dates for Year 2000 remediation, testing and implementation of systems that support the government-wide mission-critical

(GWMC) functions. The target date for their full completion was 30 June 1999.

25.23 Since January 1999, the Secretariat has been monitoring and reporting monthly on the Year 2000 progress of systems that support 43 government-wide mission-critical functions. On 26 August 1999, its last monthly report on Year 2000 progress at July 1999 noted that the overall completion index for systems supporting GWMC functions was 99 percent.

25.24 In the current audit, we noted that Year 2000 has become a priority issue for senior management. Since June 1998, when the completion rate was 50 percent, the government has made significant progress in making the critical systems compliant for Year 2000. Exhibit 25.1 shows the progression of the overall completion index since September 1997, when the Secretariat first started surveying departments and agencies and compiling data on Year 2000 progress.

25.25 The 26 August report of the Secretariat showed that 25 of the government's 43 GWMC functions had reached 100 percent completion. Another 13 were at 99 percent and 3 were at 98 percent. Systems for two of the functions were about 95 percent complete. The functions and their completion rates are shown in Exhibit 25.2.

Our review showed no substantive differences

25.26 In response to our 1998 recommendation to seek independent validation of information on progress, the Secretary of the Treasury Board wrote to deputy ministers and heads of agencies, suggesting that they assign their internal audit staff to undertake the validation. In May 1999, the Secretariat provided the government's internal audit community with further guidance on independent validation.

25.27 We reviewed the August 1999 progress report prepared by the Secretariat

and verified the information against supporting data and files at the Secretariat. We further verified the Secretariat's information against the records and files of six organizations that are responsible for seven GWMC functions. We also reviewed their contingency plans for the functions we had selected for audit. With the exception of the export and import controls function, the functions were selected on the basis of their criticality. The export and import controls function was selected because it ranked last in the completion index — 94 percent at July 1999. The six organizations and the seven GWMC functions we audited are:

- Canadian Broadcasting Corporation — emergency broadcasting;
- Environment Canada — weather forecasting;
- Foreign Affairs and International Trade — export and import controls;
- Human Resources Development Canada — income security; employment insurance;
- Public Works and Government Services Canada — Receiver General; and
- Revenue Canada — income tax processing.

As we finalized this report, Foreign Affairs and International Trade advised us that systems supporting the export and import controls function had been fully implemented in early September 1999.

25.28 The Secretariat provided us with a draft version of its August 1999 progress report. We conducted a cursory review and communicated our comments and concerns to Secretariat staff. The Secretariat addressed the issues and revised the report before its release on 26 August. Our subsequent review of the report revealed no major discrepancies between its content and the Secretariat's supporting files.

25.29 Further, we noted that where system testing and full implementation of repaired systems had yet to be completed at July 1999, all key activities were planned for completion by October 1999. The Secretariat has assured us that it will continue to monitor GWMC functions and that it will focus on organizations that have yet to fully complete the testing and implementation of compliant systems. The Secretariat also stated in its August 1999 progress report that it will keep Canadians informed on its Year 2000 activities as the situation evolves. We have asked the Secretariat to keep us up-to-date on Year 2000 progress.

Our review of the Secretariat's progress report revealed no major discrepancies between its content and the Secretariat's supporting files.

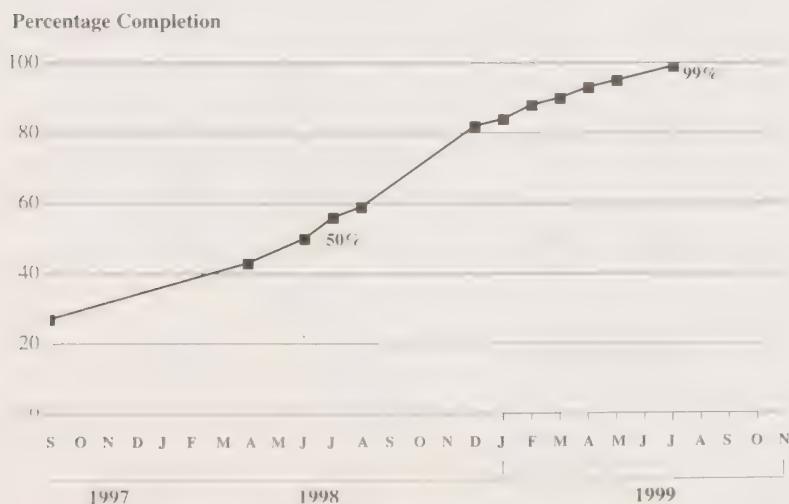


Exhibit 25.1
Year 2000 Progress of Systems Supporting Government-Wide Mission-Critical Functions

Source: Treasury Board Secretariat

Exhibit 25.2**Government-Wide Mission-Critical Functions and Their Year 2000 Completion Status**

Department, Agency or Crown Corporation	Function	Completion Index (percentage)
Atomic Energy of Canada Limited	• control, safety, monitoring and facilities management	100
Canadian Broadcasting Corporation	• communications and broadcasting system	99
Canadian Food Inspection Agency	• food production and inspection	99
Canadian Heritage (Parks Canada)	• maintenance management system	98
Canadian Security Intelligence Service	• security intelligence • security screening	99 99
Citizenship and Immigration Canada	• managing access to Canada	99
Communications Security Establishment	• foreign intelligence and information technology security	100
Correctional Service Canada	• offender reintegration	100
Environment Canada	• environmental forecasting system	99
Fisheries and Oceans	• environmental response activities • flood control • marine traffic safety • search and rescue	100 100 99 99
Foreign Affairs and International Trade	• consular affairs • export and import controls • Canadian passport office • network (messaging system)	100 94 100 95
Health Canada	• laboratory centre for disease control • therapeutic products program • food program • environmental health program • medical services	100 100 100 100 100
Human Resources Development Canada	• income security • employment insurance	100 100
Indian and Northern Affairs Canada	• band support funding	100
Department of Justice	• family orders and agreements enforcement	98
National Defence	• defence of Canada/deployed international operations • domestic operations	99 99
Natural Resources Canada	• aeronautical and technical services • seismic monitoring • geomagnetic monitoring	100 100 100

(continued)

Exhibit 25.2

(continued)

Department, Agency or Crown Corporation	Function	Completion Index (percentage)
Public Works and Government Services Canada	<ul style="list-style-type: none"> • public service compensation • Receiver General services • processing government financial transactions 	100 100 100
Royal Canadian Mounted Police	<ul style="list-style-type: none"> • law enforcement 	99
Revenue Canada	<ul style="list-style-type: none"> • social income redistribution • income tax processing • customs border services and trade administration 	100 100 100
Tax Court of Canada	<ul style="list-style-type: none"> • appeals management system 	100
Transport Canada	<ul style="list-style-type: none"> • transport regulation 	99
Veterans Affairs Canada	<ul style="list-style-type: none"> • health care • pensions and allowances 	98 99

Source: Treasury Board Secretariat, August 1999

25.30 In our review of Year 2000 remediation work and test results at the six organizations, we found no substantive differences from the information reported by the Treasury Board Secretariat. We noted some areas where improvements were possible and communicated them to the organizations in September 1999 for their consideration and action. They included such issues as further testing of external interfaces; independent testing of repaired program code; documentation and accessibility of test results; and documentation of full system accreditation and certification for Year 2000. Subsequently, management of the organizations advised us that it had considered our observations and findings, and some had started to address them.

Contingency planning was not fully complete and more testing of the plans was needed

25.31 There can be no guarantee that repaired and compliant systems will function fully after 1999. Undetected errors could exist; other infrastructures on which systems depend but that are outside

the direct control of departments and agencies could fail. Thus, contingency planning is an essential and prudent measure for addressing Year 2000.

25.32 In 1998, we recommended that contingency plans be developed and tested prior to 2000. The Secretariat established requirements in 1998 for risk assessments and high-level contingency plans. In 1999, the Secretariat and the National Contingency Planning Group jointly set target dates for all 23 departments, agencies and Crown corporations that are responsible for GWMC functions to complete various components of contingency plans. All key components of those plans were to be completed by April 1999 and submitted for review to the Secretariat and to the National Contingency Planning Group. More information on the National Contingency Planning Group can be found under **National Emergency Preparedness** (see paragraph 25.74).

25.33 Using a common checklist, the Secretariat and the National Contingency Planning Group reviewed for completeness the plans submitted by the

We brought our findings to management's attention in the organizations that we audited and encouraged each to take further action.

The two regulatory agencies used a risk-based strategy to assess the impact of Year 2000 on those they license.

23 organizations and the approval structures to be used in executing the plans.

25.34 Our review of contingency plans of the six organizations noted that some of the required components were missing and that some components contained only broadly defined information.

25.35 A common finding was that the test plans were incomplete. Most organizations did not plan to test components of their contingency plans before the start of the validation exercise that was developed by the National Contingency Planning Group. Some planned to rely primarily on that exercise in order to test their contingency procedures. The validation exercise was developed to test the government's capacity for co-ordinating a response to several concurrent emergencies and to give organizations an opportunity to test their contingency plans. It was not designed to test contingency procedures for all mission-critical systems and processes in an organization. The testing that the exercise provided may not be sufficient for all organizations.

25.36 We brought our findings to management's attention in the organizations that we audited and encouraged each to complete the contingency plans expeditiously and to test critical contingency procedures in its plans, particularly in areas of higher vulnerability. Several management responses indicated that testing, over and above the validation exercise, was planned or contemplated for November. One department advised us that it had completed many aspects of its test plan before the start of the validation exercise.

Regulatory Responsibilities

25.37 As a regulator, the government has the responsibility to ensure that the industries it regulates continue to meet regulatory requirements, notwithstanding the Year 2000 computer problem. As

previously noted, we examined two areas that are regulated by the government — medical devices at Health Canada and nuclear facilities and radioactive devices at the Atomic Energy Control Board.

25.38 The Board regulates the ongoing operations and the operators of nuclear facilities and radioactive devices. Health Canada licenses new medical devices and establishments that manufacture, import and distribute medical devices. We would expect each of the regulatory agencies to assess risks arising from Year 2000 in order to determine if further regulatory requirements would be appropriate. We would also expect them to prioritize their compliance and enforcement activities on the basis of their risk assessments.

Additional requirements were set for nuclear power reactors, higher-risk radioactive devices and medical devices

25.39 The two regulatory agencies used a risk-based strategy to assess the impact of Year 2000 on those they license. Both had prepared legal assessments, including recommendations and suggestions for action. The agencies have determined that no amendments to regulations are required in their respective areas.

25.40 Three of approximately 100 licensees of nuclear facilities are responsible for all operating nuclear power reactors in Canada. The Atomic Energy Control Board wrote to the three licensees to require that by 1 October 1998, all special safety systems — those that provide for the safe shutdown of a nuclear power reactor — be corrected, tested and made compliant for Year 2000. The systems whose failure could trigger the special safety systems were to be compliant by 31 December 1998. Finally, by 30 June 1999 the three licensees were to provide assurance to the Board that all systems were ready for continued operation into 2000, with no undue risk to health, safety, security and the environment.

25.41 The Board developed a risk profile and criteria to assess over 3,700 licensees of radioactive devices for radiological risk in the transition to 2000. A total of 443 licensees met the profile and the criteria and were thus selected to demonstrate readiness for Year 2000. Those licensees were required to respond by 31 October 1998 to a questionnaire on the status of their Year 2000 programs. By 31 March 1999, they were to submit their plans for mitigating any Year 2000 problems that could compromise the safety of their activities. Confirmation that all problems related to Year 2000 had been identified and corrected was required by 30 June 1999.

25.42 At Health Canada, the Health Protection Branch contacted about 2,040 licensed manufacturers and suppliers of medical devices to remind them of Year 2000 risks and their responsibilities under the Medical Devices Regulations of the *Food and Drugs Act*. It requested that the licensees test all devices that were still in use and report to the Branch by 30 May 1998 on the status of compliance for Year 2000. In addition, the Branch requested information on test results to support the compliance status reported. In June 1999, the Branch advised the licensees that annual licence renewal, required by 1 November, would take place only if licensees attested that date-sensitive devices were compliant for Year 2000.

Many licensees reported compliance for Year 2000 but some follow-up is still required

25.43 The licensees for nuclear power reactors have met all deadlines. We found that the Atomic Energy Control Board has addressed Year 2000 risks and exposure in its monitoring and enforcement activities for nuclear power reactors. Licensees had to demonstrate to Board inspectors that safe operations would be maintained throughout the period of the transition from 1999 to 2000. In addition, licensees

were required to demonstrate that they have contingency plans in place to accommodate any risks that are beyond their control, such as loss of electrical power and problems in the transportation and communications sectors.

25.44 With respect to the radioactive devices identified as higher-risk, about 90 licensees or one fifth of the identified group had not responded by July 1999. In total, we found that some 29 percent had yet to demonstrate that they had met the requirement to identify and rectify all Year 2000 issues by 30 June 1999 (see Exhibit 25.3). In September 1999, we reported this finding directly to the Atomic Energy Control Board and suggested that it follow up with delinquent licensees and escalate its action as appropriate. The Board acknowledged our findings and suggestions and agreed to take them into account in its remaining activities in 1999. In late September, it advised us that cases involving 13 percent of the licensees remained unresolved.

The licensees for nuclear power reactors have met all deadlines.

25.45 Using the information on Year 2000 compliance that it received from licensed manufacturers of medical devices, the Health Protection Branch of Health Canada constructed a database and made it available on the Branch's Web site. Although this is not part of the Branch's regular activities, the database provides a wealth of information for health care professionals and institutions. For the health care sector, compliance information is important on all devices that are in use, not just those that continue to be manufactured.

25.46 The devices are classified into four risk classes according to the Medical Devices Regulations of the *Food and Drugs Act*. Class IV devices are those with the highest risk to the human body and Class I are those with the lowest risk. For example, Class IV devices include implanted cardiac pacemakers and other life support systems; Class III devices

include X-ray machines and certain types of resuscitators.

25.47 After receiving information from licensees, the Health Protection Branch categorized their responses by status of compliance for Year 2000. According to information in the database, licensed manufacturers of all Class IV devices and over 75 percent of those of Class III devices have responded and provided compliance information. Exhibit 25.4 shows the status of the database at September 1999.

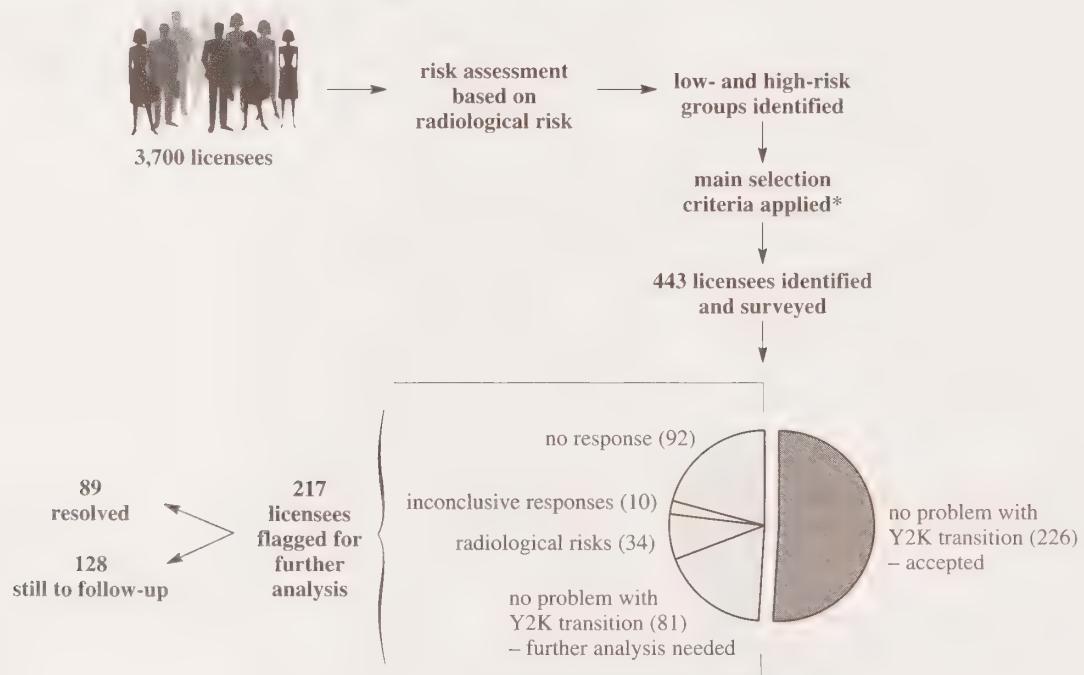
25.48 We conducted a sample check of about 48 devices on the database and compared compliance information on the Department's Web site with its documents

and files or the manufacturer's Web site. We found several cases where, in our view, further follow-up was appropriate. For example, several Class IV devices were recorded as compliance category 5 (device no longer sold, company does not have compliance information). Users of those devices have no compliance information from Health Canada.

25.49 We reported the detailed findings of our sample check to the Department and suggested that it consider further follow-up with licensed manufacturers to make the database more useful to health care users. We also suggested that the Department consider the merits of further reviewing its database and following up on other delinquent licensees. In

Exhibit 25.3

Status of Responses From Licensees of Radioactive Devices Identified as Higher-Risk



* Main Selection Criteria

- Size of source of radiation
- Likelihood of exposure
- Potential to hit or exceed a targeted level of safety
- Level of automation of processes
- Complexity of the licensed activity
- Ability to modify equipment to make it Y2K vulnerable
- Degree of regulatory control and oversight

Source: Examinations of internal documents and interviews with project officials, July 1999

mid-September, the Department advised us that it would look at the specific gaps we had noted in its database.

Other Government-Wide Issues

25.50 In our two previous audits, we identified several areas where departments have common needs and where efficiencies could be gained by addressing common issues horizontally. In the current audit, we followed up on three specific horizontal issues and the Treasury Board Secretariat's response to our recommendation that government reporting to Parliament on Year 2000 progress be improved.

Review of departmental contingency plans

25.51 The development of contingency plans was a key activity for organizations in 1999. The Secretariat identified the need to oversee the development of contingency plans in the 23 departments, agencies and Crown corporations that are responsible for government-wide mission-critical functions.

25.52 We note that the Secretariat has issued guidelines to assist individual departments in preparing contingency plans. In addition, it has held workshops and information sessions in co-operation with the National Contingency Planning Group to explain the guidelines.

25.53 According to targets set by the Treasury Board Secretariat and the National Contingency Planning Group, all components of the 23 sets of departmental contingency plans were to be completed by April 1999. In addition to risk analysis and a contingency plan overview, the components also include plans and procedures for crisis response, business resumption, training and testing.

25.54 During the audit, we reviewed the contingency plans of eight departments and agencies and noted that some key deliverables either had not been

submitted or were broadly written documents with few details. For example, in June 1999 the Secretariat had not received from five of the eight departments their completed plans and procedures for crisis response and business resumption. We followed up on the updates prepared by the six departments we audited for GWMC functions. Most of them had completed the crisis response portion of the plans; two departments needed to complete additional details for business resumption.

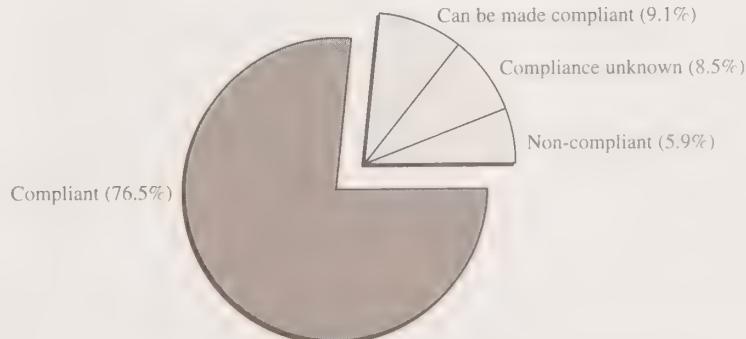
25.55 The Secretariat has developed a checklist as a tool to oversee the completeness of contingency planning documents at departments and agencies. We noted that for some key deliverables, the Secretariat would consider that the organization had met the requirements if it had:

- completed the procedures; or
- provided a workplan for their completion; or
- stated in writing that further work was not necessary.

25.56 We suggested to the Secretariat in its oversight role that before accepting contingency plans as complete, it seek

Exhibit 25.4

Status of Health Canada's Database on Year 2000 Compliance of Medical Devices



Source: Health Canada, September 1999

The government has been providing up-to-date information related to Year 2000 on its Web sites.

additional information from the department or agency to satisfy itself that the key deliverables could be completed in time or that no further work was needed. The Secretariat advised us that its first-phase checklist focussed on the robustness of the contingency planning regime and that it has developed a checklist for a second phase to monitor the finalization of the plans. The Secretariat indicated that it was in the process of implementing this second phase of monitoring.

Government-wide communications strategy for Year 2000

25.57 The need for a communications strategy for the government as a whole was also identified as a key activity for 1999. From a government perspective, there needs to be a consistent and coherent approach to providing Year 2000 information to stakeholders and the public. From a public perspective, there is a need to be kept informed about the government's readiness so that individuals and organizations can make their own plans in advance of January 2000.

25.58 Working with key departments and the Privy Council Office, the Secretariat has developed a government-wide communications strategy. Its stated objective is:

To provide relevant, timely and credible information to all publics in a proactive manner on the action taken by government departments and its provincial/territorial and private sector partners, in order to build and maintain public confidence and to encourage preparedness for the Year 2000 transition.

Overall funding of \$1.5 million has been approved for Year 2000-related communications over a period of about 18 months ending in March 2000.

25.59 We found the strategy to be comprehensive. It covers three key

audiences — inside the government, external domestic and external international. It also has a list of key messages to be communicated. One is that the government's overall priority is making sure that the systems essential to the health, safety, security and economic well-being of Canadians are compliant for Year 2000 and providing leadership to encourage Canadians to meet the Year 2000 challenge.

25.60 The strategy considered the need to provide Canadians with timely, factual and useful information throughout 1999. It emphasized the need for the government to be transparent about its state of preparedness for delivering essential services and to be accurate in providing third-party information. Where third-party information has not been verified, the government intends to clearly state that fact.

25.61 At September 1999, we noted that the government had prepared and sent Year 2000 information flyers to Canadian households. It has held a number of events to communicate not only its own Year 2000 progress but also the state of preparedness of key industries and utilities such as banking, hydroelectricity and telecommunications services. Moreover, the government has been providing up-to-date information related to Year 2000 on its Web sites and through its toll-free telephone enquiry service.

Funding for Year 2000 projects

25.62 In 1997, we identified the issue of funding for Year 2000 as a risk that could delay Year 2000 readiness. In 1998, we noted that the Secretariat had established a mechanism to loan funds to the 23 departments, agencies and Crown corporations that are responsible for government-wide mission-critical functions. By July 1998, \$365 million of a \$400 million budget had been loaned.

25.63 In 1999, additional submissions have been made to the Treasury Board for Year 2000 loan funding. By 25 August

1999, approved loans had risen to \$723 million. Nineteen departments, agencies and Crown corporations requested a total of \$592 million in Year 2000 loan funding for GWMC functions. Seven of those organizations also requested loan funds for their department-wide mission-critical functions. In addition, five organizations that are not responsible for GWMC functions requested loan funds for Year 2000 projects to prepare their department-wide mission-critical functions. Loans for department-wide mission-critical functions totalled \$131 million.

25.64 We note that the standard term for repayment is three years commencing in 2001–02 but that it can be reviewed, depending on affordability, where the ability to deliver programs is at risk.

25.65 Given the magnitude of Year 2000 projects and their immovable deadlines, many organizations have put other development projects on hold and kept systems maintenance to a minimum. The 24 departments and agencies that received Year 2000 funds will be faced with balancing additional demand for new information technology projects while repaying their loans. Furthermore, departments and agencies are planning to implement a common information management and information technology infrastructure and other systems changes to support electronic service delivery. In our view, the Secretariat needs to ensure that the loan repayment takes into account the ability of departments and agencies to support electronic service delivery.

Managing transition to Year 2000

25.66 The “transition period” for Year 2000 is the period around 1 January 2000, when special measures may have to be introduced to monitor and resolve any problems that may arise.

25.67 In March 1999, the Secretariat and departments discussed the concept of

transition management and the need for a co-ordinated approach to this rollover period. A Transition Study Group was formed, with 10 departments participating. In June 1999, the Group completed a guideline entitled “The Year 2000 Transition of Production Information Systems”. This Treasury Board Secretariat guideline was intended to assist departments and agencies in planning for transition management in their own entities.

25.68 Together with departments and agencies, the Secretariat has a role in co-ordinating and managing the Year 2000 transition for all GWMC functions.

25.69 Departments and agencies have been setting their own rollover periods for managing the transition. The Year 2000 Project Office at the Secretariat has been referring informally to the period from 15 December 1999 to 15 January 2000 as the likely period for co-ordinating and managing the Year 2000 transition, but this has not been formalized. By early September 1999, few details had been determined on how multiple problems in different GWMC functions would be co-ordinated and managed at a government-wide level.

25.70 We suggested to the Secretariat that it expedite planning to co-ordinate and manage the Year 2000 transition on a government-wide level; consider setting a time frame as the government-wide rollover period for Year 2000; and determine the respective roles and responsibilities of various parties, including the National Contingency Planning Group (NCPG). The Secretariat has advised us that it has had discussions with the NCPG to clarify its role for government-wide mission-critical functions.

Reporting to Parliament

25.71 In its response to our 1998 recommendation calling for improved reporting to Parliament, the Treasury Board Secretariat indicated that it would

In our view, the Secretariat needs to ensure that the loan repayment takes into account the ability of departments and agencies to support electronic service delivery.

The government also gives priority to the possible need for responding to major disruptions in Canada or to a series of smaller incidents in several locations as a result of the Year 2000 computer problem.

continue to examine ways of keeping Parliament informed.

25.72 It has done this through the House of Commons standing committees on Industry and on Public Accounts. In 1997 and 1998, the Secretariat provided testimony to the Industry Committee on the government's Year 2000 progress. A number of departments also provided testimony to that Committee. To the Public Accounts Committee, in addition to providing testimony in several hearings in 1997 and 1998, the Secretariat submitted two progress reports in 1998. Since January 1999, it has provided monthly reports to the Public Accounts Committee. The 26 August report on the status of progress at July 1999 was the last in that series.

25.73 In the current audit, we found that the Secretariat had improved the format and content of its Year 2000 progress reporting to the Public Accounts Committee. Instead of reporting the progress made in each organization, it provided information on progress in each of the 43 government-wide mission-critical functions. In almost all cases, progress in department-wide mission-critical functions for the 23 departments, agencies and Crown corporations was included in those reports.

National Emergency Preparedness

A formal group was set up to co-ordinate the development of national contingency plans

25.74 As we have noted, planning for Year 2000 contingencies is prudent and essential to ensure that critical functions continue. Although high priority is given to plans and procedures for working around systems that support government-wide mission-critical functions, the government also gives priority to the possible need for responding to major disruptions in Canada

or to a series of smaller incidents in several locations as a result of the Year 2000 computer problem.

25.75 National Defence was given the responsibility to lead and co-ordinate these efforts. In October 1998, a federal official was appointed to co-ordinate and facilitate the development of national contingency plans for Year 2000. The group that he leads, the National Contingency Planning Group (NCPG), comprises a dedicated staff of about 80 people, mostly on assignment from various departments and agencies. As part of this national support initiative, the operations of Emergency Preparedness Canada have been integrated into those of the NCPG but for Year 2000 activities only. Operation Abacus was set up separately at National Defence to prepare the Canadian Forces to respond to requests from civil authorities for assistance.

25.76 The NCPG conducts and co-ordinates a number of concurrent events. Exhibit 25.5 provides a simplified view of its key activities. One major milestone was the identification of elements of critical national infrastructure, such as transportation and utilities, and assessment of the risk of their potential Year 2000 failure. Another key activity was the development of a national validation exercise planned for the end of September 1999. Starting in October 1999, the NCPG planned to shift its focus to transition period activities, like co-ordinating available Year 2000 information within government for the appropriate authorities.

Many tasks were accomplished, including preparing for the validation exercise

25.77 In February 1999, the Group finished identifying and defining elements of Canada's critical infrastructure. We noted that its national infrastructure risk assessment (NIRA) is a detailed bimonthly assessment by element, based on two factors — the criticality of the

infrastructure element and the likelihood of Year 2000 failure.

25.78 The assessment of criticality was based on information the NCPG collected from a broad group of stakeholders, including key industries and other levels of government. It assessed the likelihood of Year 2000 failure on the basis of the state of preparedness for Year 2000 and progress in developing contingency plans. The interdependencies identified in those plans were used in assessing the potential impact of failure of critical infrastructure elements.

25.79 We reviewed two elements of one NIRA and noted that the assessments were thorough and complete. At early September 1999, the NCPG had

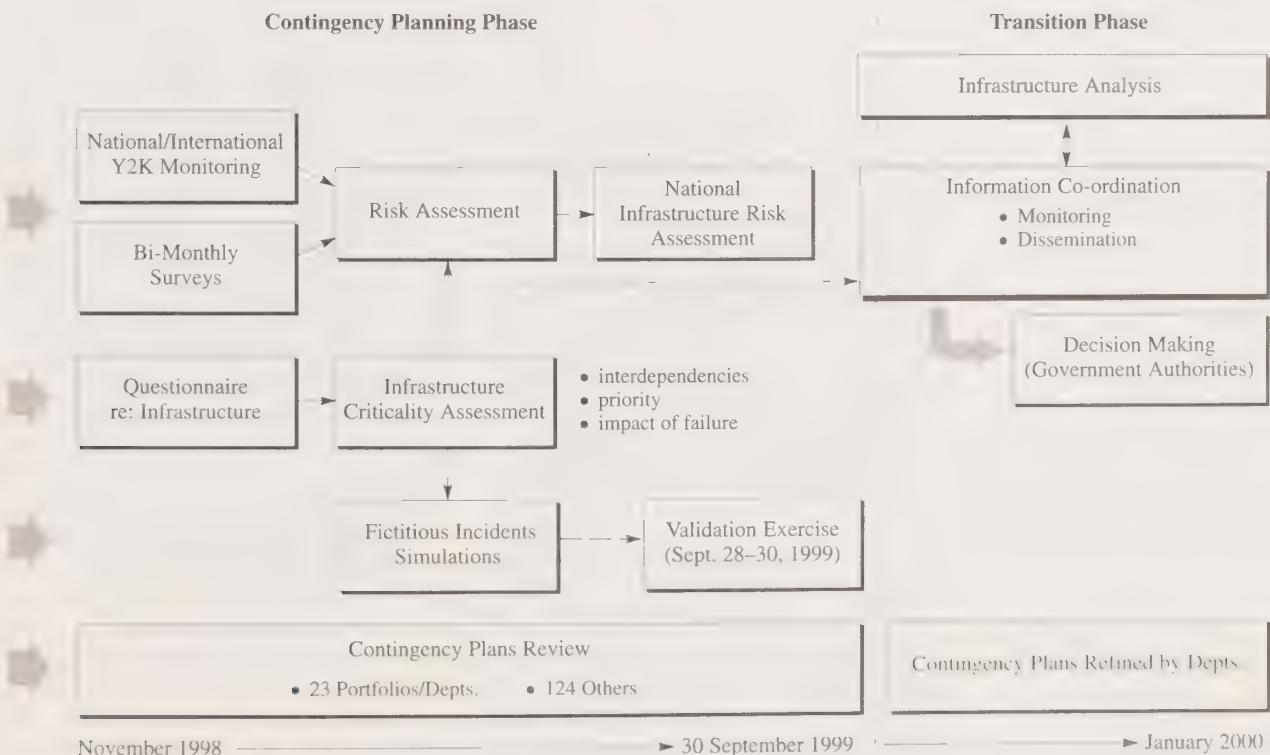
completed three NRAs. It planned to complete three additional assessments, the last by mid-December 1999.

25.80 Using the assessment of criticality, the NCPG formulated fictitious incidents for the three-day NCPG validation exercise. The purpose of the exercise was to evaluate the government's capacity to co-ordinate a response to several concurrent emergencies, and to provide an opportunity for organizations to test their contingency plans. All 23 mission-critical departments, agencies and Crown corporations were required to participate in that exercise; participation by other organizations was voluntary. The validation exercise was held at the end of September 1999. The NCPG has advised us that the exercise proved to be very

The National Contingency Planning Group has advised us that the validation exercise proved to be very useful.

Exhibit 25.5

Key Activities of the National Contingency Planning Group



Source: Simplified and adapted from various documents of the National Contingency Planning Group

National Defence
planned to put in place
its command and
control structure after
30 November 1999 and
to be on standby for
potential requests for
assistance across
Canada starting
31 December 1999.

useful and that several companies from industry also participated. It indicated that various organizations were analyzing the results to improve their plans, particularly the way information was to be analyzed and communicated during an incident.

25.81 The National Contingency Planning Group also played an important role in reviewing the contingency plans of government departments and agencies. By 30 April 1999, the 23 departments and agencies that are responsible for government-wide mission-critical functions were to complete various components of their contingency plans and submit them to the Treasury Board Secretariat and the NCPG for review. Moreover, using the same target dates, the NCPG called for the submission of contingency plans from 124 other departments and agencies. In total, 147 organizations were expected to submit their contingency plans to the NCPG for review.

25.82 We found at 10 September 1999 that 50 of the 147 organizations had not completed contingency plans to meet all requirements that had been set for April 1999. In addition, 6 organizations had not filed any contingency plans. We also noted a general tendency of departments and agencies to rely primarily on the NCPG validation exercise to test their contingency plans. This was partly the purpose of that exercise, but it was not designed to challenge all significant operations of an individual department.

25.83 We communicated our findings to the NCPG in September 1999 and suggested that it follow up further on delinquent departments and agencies and those that had not completed their contingency plans. We also suggested that the NCPG continue to encourage the organizations to complement the validation exercise with their own testing.

Measures were being put in place to respond to possible requests for emergency assistance

25.84 Emergency Preparedness Canada is one of several important players on an integrated transition team of the government for co-ordinating federal responses to Year 2000 disruptions. It has reorganized its National Support Centre, ordinarily used for isolated major emergency events to collect, analyze and disseminate information on Year 2000 events from around the country and internationally and to support the co-ordination of federal responses.

25.85 In August 1999, senior analyst support for operations was available only during regular hours. Over the fall of 1999, Emergency Preparedness Canada expected to fully staff three shifts to allow for comprehensive support on a 24-hour, seven-days-a-week basis. As we concluded our audit, the Secretariat and the NCPG were clarifying their respective roles.

25.86 In preparing to respond to possible requests for assistance as a result of Year 2000 disruptions, National Defence had modified the leave policy for its forces between 15 November 1999 and 31 March 2000. In August 1998, Operation Abacus was initiated to prepare the Canadian Forces. Most of the efforts in the past 12 months have involved planning for a number of essential activities, such as assessing potential demands for assistance and training Canadian Forces personnel.

25.87 As of mid-September 1999, National Defence had released to its staff the final draft of the Operation Abacus operating instructions. It was completing its planned training exercises and preparing to participate in the NCPG validation exercise, with a focus on elements of command, control and communications. It planned to put in place its command and control structure after 30 November 1999 and to be on standby

for potential requests for assistance across Canada starting 31 December 1999. National Defence anticipated that its forces would remain on call for 30 days or longer as needed, following the last week of December 1999. Its command, control, communications and liaison structure would remain in place until the end of March 2000 if necessary.

Looking Beyond Year 2000

25.88 Reflecting upon this \$2 billion Year 2000 project, we observed several issues that are worthy of consideration for action beyond December 1999.

Government date standards need to be observed

25.89 Information technology standards for departments and agencies are set by the Treasury Board through its Treasury Board Information Technology (TBIT) standards program. As we noted in the follow-up to our September 1996 Report Chapter 16 (see Chapter 32 of this Report, paragraph 32.26), the TBIT standards program has remained largely at the policy level and, to date, has not been implemented by departments and agencies.

25.90 The TBIT standards for date coding were set as far back as 1988. In TBIT standard-36, "all-numeric representation of dates and times", the standard requires an eight-digit date code for a calendar date, in three elements in the order of year-month-day (seven digits for a Julian date, in the order of year-day of year). Had the TBIT date standard been observed in the past, the scope and extent of the government's Year 2000 work would have been greatly reduced.

25.91 In considering a Year 2000 remediation strategy, many organizations in both private and public sectors turned to a "windowing" technique instead of expanding the two-digit year code to four. That strategy is more efficient and can reduce the potential for introducing errors

into application systems through date expansion.

25.92 In the government, each department and agency determined its own remediation strategy for Year 2000. From the Year 2000 audits we conducted, we noted that both date expansion and windowing remediation strategies were used. Moreover, in the departments and agencies we reviewed (nine in 1997 and six in 1998, three of which had also been examined in 1997), none of the remediation strategies referred to the TBIT standards or to a migration plan in the future to meet those date standards.

25.93 The windowing technique requires ongoing maintenance to ensure that systems interpret the year properly. For example, the repaired Canada Pension Plan system will be able to recognize years up to and including 2065; changes will have to be made to the system before it can accept years beyond that year. We noted that some departments have department-wide date standards, but this is not a standing feature in all departments and agencies. Standardized representation of a data element as ubiquitous as the date would foster interoperability among departments and support the government's agenda to integrate services in order to better serve the public. In our view, the TBIT date standards need to be observed.

25.94 The Treasury Board Secretariat should ensure that all departments and agencies are made aware of the existing government date standards and that departmental plans are in place to comply with them in future upgrades and maintenance of departmental systems.

Government's response: The Year 2000 issue has increased awareness of the Treasury Board Information Technology date standard, and the importance of standards in general. As part of the Year 2000 close-down procedures, the Secretariat will issue a memorandum to departments reminding them of the date standard and urging that it be

Had the Treasury Board Information Technology date standard been observed in the past, the scope and extent of the government's Year 2000 work would have been greatly reduced.

Year 2000 could continue to plague systems and operations beyond 1 January 2000.

implemented when amending existing, or developing new, date processing logic.

Once the government has successfully transitioned from Year 2000 activities, the Chief Information Officer Branch of the Secretariat will undertake a review of the status of departments' use of date formats and windowing techniques to determine the need for further direction and guidance.

Opportunity to harness Year 2000 legacy

25.95 The Year 2000 computer problem provided an opportunity for organizations to better understand not only their dependence on information technology but also their interdependence with partners and stakeholders. Moreover, Year 2000 projects provided an impetus for organizations to thoroughly document their information systems and devices and determine their criticality to the organizations.

25.96 As never before, contingency planning became a key activity. Staff in information technology and business units worked together to make major decisions such as identifying mission-critical activities, determining minimum acceptable levels of service and developing contingency procedures for maintaining them.

25.97 Information technology changes at a rapid pace. The government's move to electronic service delivery will also change service channels and procedures. Without regular updates, systems inventories and contingency plans will soon be out-of-date. Information bases such as systems inventories and contingency plans are a Year 2000 legacy that ought to be valued and maintained.

25.98 The Treasury Board Secretariat should consider requiring departments and agencies to maintain and update valuable information bases, such as systems inventories and contingency

plans, that were developed to respond to Year 2000.

Government's response: The Year 2000 Project Office of the Secretariat has established an interdepartmental committee to identify, recommend and support Year 2000 project completion activities. A key objective of the work of this committee will be to help ensure that the products and benefits of the project are preserved and exploited.

Need for vigilance over potential Year 2000 pitfalls

25.99 From discussion with analysts in the information technology industry and a review of related articles, we noted that Year 2000 could continue to plague systems and operations beyond 1 January 2000. Some have identified 1 March 2000, the first day after 29 February, the leap year date, as a problem date that could equal 1 January 2000 in its impact. Others noted that problems could continue well into 2000.

25.100 An example of such problems is the risk of data corruption. Incorrect data could be introduced through undetected errors in an application system. Further, the more a system interfaces externally with other systems, the higher its exposure to the risk that data could be tainted by non-compliant data sources or by misinterpretation of incoming data.

25.101 Another example is the risk that archived data will be inaccessible. As systems have been repaired or replaced, not all organizations have paid due regard to the data that they have archived. There is a risk that new systems will not be able to access archived data and, since the old systems are not Year 2000 compliant, they cannot be used beyond 1999.

25.102 In our view, the government needs to remain vigilant beyond 1999 and keep watch over potential Year 2000 pitfalls.

25.103 The government should ensure that departments and agencies have

procedures in place to guard against potential Year 2000 pitfalls after January 2000.

Government's response: In recognition of the continued threat of Year 2000 problems past 1 January 2000, the government plans to continue to dedicate resources to the issue into the new year. The Year 2000 Project Office of the Secretariat will maintain existing staffing levels until 31 March 2000. Provisions have been made to continue an office at reduced levels throughout the 2000–2001 fiscal year. The list of dangerous dates published to departments and agencies included 29 February 2000 of the leap year.

We expect that the interdepartmental project completion committee, mentioned in the response to paragraph 25.98, will also identify ongoing measures that should be put in place to offset potential Year 2000 threats.

Conclusion

25.104 We set out to assess the government's progress in preparing its government-wide mission-critical functions for Year 2000; its activities to discharge its regulatory responsibilities in the face of Year 2000 risks; and its efforts to prepare for national emergencies that may arise after December 1999.

25.105 In August 1999, the Secretariat reported that systems supporting government-wide mission-critical functions had achieved an overall completion rate of 99 percent at July 1999. Organizations with those systems that required additional testing and full implementation were planning to complete them in September and October

1999. We concluded that the government has made significant progress since our audit in 1998.

25.106 We noted that departments and agencies have made major efforts to develop contingency plans. In the departmental contingency plans we reviewed, contingency procedures had largely been defined but some components were not complete, and few departments had developed test plans when we completed our audit in early September.

25.107 We found that Year 2000 requirements had been established for licensees of nuclear power reactors and radioactive devices as well as medical devices. Although we observed a need for some follow-up, the licensees for active nuclear power plants had met all regulatory requirements to prepare for Year 2000; compliance information on medical devices had been requested and made available to health care professionals and institutions.

25.108 In preparing for a national emergency, the National Contingency Planning Group identified elements of critical national infrastructure and assessed the risks presented by Year 2000. The Group also developed a validation exercise and set up an information and response co-ordination centre. Operation Abacus in National Defence was establishing a structure to support any emergency assistance that may be required in 2000.

25.109 As we completed our audit in September 1999, much had been accomplished in the areas we audited. Nevertheless, some Year 2000 work programs still have to be completed and the government needs to remain vigilant to minimize any Year 2000 disruptions.



About the Audit

Objectives

The 1999 audit focussed on the government's final preparation for the Year 2000 computer problem. The objectives of the audit were to assess:

- the progress that the government has made in this final year in remediating and testing systems that support government-wide mission-critical functions and in implementing them;
- government efforts to provide for national contingencies and emergencies; and
- Year 2000 activities for discharging regulatory responsibilities.

Scope

We reviewed Year 2000 progress reports prepared by the Treasury Board Secretariat, and the supporting files. For seven mission-critical functions, we also examined results of remediation and testing at the responsible department or Crown corporation. Those functions and the six organizations responsible for them are as follows:

- emergency broadcasting (Canadian Broadcasting Corporation);
- weather forecasting (Environment Canada);
- export and import controls (Foreign Affairs and International Trade);
- income security (Human Resources Development Canada);
- employment insurance (Human Resources Development Canada);
- Receiver General (Public Works and Government Services Canada); and
- income tax processing (Revenue Canada).

We also examined several horizontal issues managed and overseen by the Secretariat, such as the government's communications strategy and departmental contingency planning.

For national emergency preparedness, we interviewed staff and examined files of the National Contingency Planning Group and Operation Abacus at National Defence. We selected two regulatory functions that can impact public health and safety — medical devices regulated by Health Canada and nuclear facilities and radioactive devices regulated by the Atomic Energy Control Board.

The government assigned additional Year 2000 responsibilities to four departments and agencies — Treasury Board Secretariat for monitoring government readiness; Industry Canada for preparing the private sector; Foreign Affairs and International Trade for monitoring international activities; and National Defence for responding to national emergencies. The audit did not extend to those activities under Industry Canada or Foreign Affairs and International Trade.

In addition to systems that support government-wide mission-critical functions, departments and agencies have systems that are critical to their own operations. We did not audit those departmental mission-critical systems.

The audit was not designed to and did not provide assurance that the government will be able to deliver all government-wide mission-critical functions in 2000. It did not provide assurance that, relative to Year 2000, adequate steps had been taken by the regulatory agencies for areas they regulate or that the government will be ready to respond to national emergencies.

The government remains responsible for its systems and their ability to continue to function properly beyond 1999. Its regulatory agencies are responsible for discharging their responsibilities relating to Year 2000 and it remains a government responsibility to be able to respond to national emergencies.

Criteria

Where appropriate, detailed criteria are discussed in sections containing our observations and findings. The general criteria for the audit were as follows:

Government preparedness

- Departments and agencies should conduct Year 2000 work on systems supporting critical functions in accordance with departmental plans and target completion dates set out by the Treasury Board Secretariat, to ensure that compliant systems for critical functions are successfully implemented before 2000.
- Departmental Year 2000 project management offices should provide sufficient, appropriate and timely progress information to senior management and the Secretariat on a regular basis.
- The Treasury Board Secretariat should monitor monthly Year 2000 progress on government-wide mission-critical systems at departments and agencies. Strategic intervention should be exercised as appropriate.
- For all critical functions, contingency plans and business resumption plans should be prepared and tested and, where warranted, be put in place before 2000.
- The Treasury Board Secretariat should co-ordinate and facilitate departmental Year 2000 efforts on common issues, including a Year 2000 communication strategy, to expedite progress and maximize cost effectiveness. Where appropriate, the Secretariat should provide guidance to assist departments and agencies in their Year 2000 work.
- Parliament should be kept informed of matters of significance arising from the Year 2000 challenge and its effects on government operations and service delivery.

National emergency preparedness

- The National Contingency Planning Group should :
 - identify potential risks to Canada's critical national infrastructure arising from possible Year 2000 disruptions, based on information provided by responsible organizations; and

- co-ordinate the development of contingency plans at the national level by facilitating, through responsible departments and agencies, the participation of those sectors comprising Canada's critical infrastructure.
- Measures should be put in place to prepare for potential Year 2000 disruptions of the national infrastructure and to respond to them should federal assistance be requested or required.

Regulatory agencies

- As part of its regulatory responsibilities over licensees, the agency should identify risks associated with potential Year 2000 disruptions and set out regulatory requirements as appropriate to ensure that its responsibilities are properly discharged.
- The agency should prioritize its enforcement activities based on Year 2000 risk assessments of its licensees to minimize the impact on public health and safety. Consideration should also be given to results of legal analysis and assessment.

Audit Team

Assistant Auditor General: Doug Timmins

Principal: Nancy Cheng

Directors: Maria Wisniowski, Greg Boyd, Tony Brigandi and Guy Dumas

Joe Lajeunesse

Peter Taylor

For additional information, please contact Nancy Cheng.

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Matters of Special Importance – 1999

Foreword and Main Points _____ Bilingual

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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 26
National Defence –
The Proper Conduct of Public Business

Chapter 27
National Defence –
Alternative Service Delivery

November 1999

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November 1999

This November 1999 Report comprises 14 chapters, including “Matters of Special Importance”, as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients’ needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 26

National Defence
The Proper Conduct of
Public Business

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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National Defence

The Proper Conduct of Public Business

Main Points

26.1 National Defence has taken positive steps in each of the areas we reviewed in this audit: active support of ethical conduct, internal control and audit, and follow-up on complaints. However, each of these areas requires further improvement.

26.2 The Defence Ethics Program, initiated by the Department in 1994 as a key response to ethical problems that had surfaced in recent years, has not yet been fully implemented throughout the Department and the Canadian Forces. The central design of the program has been completed, ethics components have been added to some training courses and ethics training for new recruits is progressing at a satisfactory pace, but other key elements are still not in place. In the military services there is a lack of commitment to the program, and its integration into personnel systems varies widely. The Department needs to move forward and make the program fully operational as soon as possible. To do so, it needs to develop an action plan with clear dates and deliverables.

26.3 We also found weaknesses in the departmental control systems, including internal controls, internal audit and the military police. There is evidence that in some areas, controls over financial and materiel resources have weakened. While the central internal audit group has recently completed several studies of risks associated with delegated resource management, we are concerned that internal audit resources have fallen below prudent levels and that decisions about the level of compliance audit work necessary to detect and deter fraud and abuse are not based on adequate risk analysis. A few local commanders do not fully understand the new role of the Canadian Forces Provost Marshal in setting policy and standards for the military police. This has resulted in instances of interference.

26.4 We examined how the Department responded to complaints directed to senior departmental management in National Defence headquarters. Allegations of such abuses of resources as unauthorized upgrading of official residences and misappropriation of government property have not always been dealt with adequately. Corrective action has been inconsistent and remedial action is slow. We have recommended that the Department track all complaint cases and ensure that they are resolved expeditiously.

Background and other observations

26.5 In recent years, National Defence has suffered from several highly publicized breakdowns in management and leadership conduct, most notably the subject of the Somalia Inquiry, and others related to misuse of resources. Over the past five years, the Department has also undergone extensive change: its budget has been reduced by almost 25 percent, an entire level of management has disappeared, and management has been substantially decentralized. This has posed significant challenges to the maintenance of management controls and the reform of the Department.

26.6 In response to identified problems, senior officials in the Department directed the development of the Defence Ethics Program in February 1994. The program that was developed was approved in December 1997. It is based on the *Statement of Defence Ethics*, which consists of principles (respect, service and obedience to lawful authority) and obligations (integrity, loyalty, honesty, courage, responsibility and fairness). The program is intended to be implemented from the top down by group principals at headquarters and by the navy, army and air force chiefs of staff.

26.7 The Department's strategy for implementing the Defence Ethics Program includes raising awareness, providing ethics training for military members and civilian employees, encouraging discussion and open dialogue and finding means to deal with ethical issues. It also includes assessing areas of risk to identify specific ethical problems. One of our objectives in this audit was to determine the extent to which the Defence Ethics Program has addressed the problems identified so far.

26.8 In addition to the Defence Ethics Program, the Department continues to rely on controls such as internal audit, military police and management checks on compliance. We examined these areas as well. We also assessed whether National Defence responds appropriately to complaints about misuse of resources or misconduct.

The Department responded positively to our recommendations and agreed to make several improvements. It said it would re-emphasize the responsibilities of managers for implementing the Defence Ethics Program and would assist them in making plans. The Department agreed to strengthen the risk analysis required to guide audits in the individual military services. It hopes to use automated data analysis to analyze transactions in order to identify irregularities. Finally, the Department said it is now tracking responses to complaints of abuse and is confident that most assessments will be complete within one year.

Introduction

What is “the proper conduct of public business”?

26.9 The proper conduct of public business has been a long-standing concern of the federal public service, including the Canadian Forces. “Proper conduct” means not only that management acts in compliance with laws and policies but also that resources are used to benefit the public, not the individual public servants to whom public funds are entrusted. Management policies and practices must pass the test of stewardship: guarding and using public funds and resources as if they were one’s own. Lapses in proper conduct can therefore range from criminal acts to merely poor business judgment. Exhibit 26.1 depicts the types of lapses that can occur.

26.10 In order to reduce the risk that improper conduct will occur, management must control risk. Our September 1998 Report Chapter 15, Promoting Integrity in

Revenue Canada, summarized what this entails. First, management must ensure that appropriate values are communicated to staff and accepted by them. At National Defence, the Defence Ethics Program is the main vehicle for communicating ethical values (see Exhibit 26.2).

26.11 Second, reducing risk requires effective internal controls and internal audit. Internal controls are the traditional methods and measures put into place by management to prevent and detect both error and misconduct. Internal audit provides management with an independent evaluation of how well those controls are working.

26.12 Third, appropriate corrective action must be taken when employee misconduct is suspected. It is important that such behaviour be investigated and discipline applied. Feedback from the monitoring and analysis of incidents of misconduct can be used by the responsible managers to improve controls and encourage conformance with corporate values.

Type	Definition	Example
Dishonesty	Laws or policies are intentionally broken, resulting in benefit to the individual committing the act.	Officials claimed and received allowances by making false statements.
Abuse	Public resources are used in a way that benefits the individual making the decision, but where there is little or no increase in public well-being. Regulations or policies may not actually be broken.	Extravagant improvements to official residences.
Claimed Misunderstanding	Individuals claim or accept benefits that are outside the intent of policy, but can plausibly claim that they misunderstood what the policy was.	Officials used a loophole in regulations to make a claim for reimbursement for expenses already paid for by a vendor corporation. The intent of travel policy is to reimburse employees for legitimate expenses.
Waste	A departmental program benefits employees, but does not have demonstrable value to departmental objectives.	An official residence maintained for representational purposes, but where few representational events take place.

Exhibit 26.1

Types of Lapses in the Proper Conduct of Public Business

Ethical conduct is a long-standing concern of the federal government

26.13 Ethical conduct has been given renewed attention in the federal public service in recent years. The Clerk of the Privy Council identified public service values as an important issue and set up a task force on Public Service Values and Ethics. The resulting report in 1996 — *A Strong Foundation* — recommended the establishment of an office to advise public service managers on ethics and values. The report emphasized the importance of values such as integrity, honesty, probity, and careful stewardship of public resources. In 1999, the Treasury Board Secretariat set up an Office for Public Service Values and Ethics, which was to report to the Secretariat by September 1999. That Office complements the role of the Prime Minister's Ethics Counsellor to Cabinet.

Military ethics are unique

26.14 National Defence is different from other federal departments. The Department exists, in part, to support the Canadian Forces — whose members

perceive themselves as distinct from the rest of society. In this perception, the Canadian military is no different from armed forces in other democratic countries. In 1869, William Windham described armed forces as “a class of men set apart from the general mass of the community, trained to particular uses, formed to peculiar notions, governed by peculiar laws, marked by peculiar distinctions.” The Canadian Forces constitute a proud and distinctive community within Canadian society, prepared if necessary to make the ultimate sacrifice on its behalf and committed to common Canadian values in matters of public trust.

26.15 As a result of their mandate, most military organizations develop a unique culture, such as the regimental system in the Army. The regiment becomes the family that influences all facets of military life. According to a 1996 departmental Board of Inquiry in its report *Command Control and Leadership in Canbat 2*:

It is a well accepted axiom that a soldier’s regiment is his family. Many studies of battlefield stress and why

Exhibit 26.2

Responsibilities for Managing the Risk of Abuse of Resources at National Defence

All managers are responsible for insuring that adequate controls are in place to protect resources and ensure compliance with regulations.

The Chief Review Services plays several roles. This headquarters group:

- is the program authority for the Defence Ethics Program;
- performs review services on behalf of the Deputy Minister and the Chief of the Defence Staff;
- contains the **Directorate of Special Examinations and Enquiries** that investigate allegations or instances of impropriety, mismanagement and other irregularities.

The military chiefs of staff are responsible for:

- the implementation of the Defence Ethics Program in their service;
- audit and review in their service.

The Canadian Forces Provost Marshal develops police policy and plans and provides specialized and investigative services including the **National Investigation Service**, which investigates matters of a “serious or sensitive” nature.

The Military Police perform routine investigations at the unit level.

The Ombudsman acts as an independent, neutral and objective sounding board, mediator and reporter to help individuals access existing channels of assistance and redress. He also reviews internal processes to ensure that individuals are treated fairly and equitably.

soldiers fight have reinforced the notion that a soldier will risk his life for his comrades and for the honour and survival of his regiment. This issue is fraught with emotion. Many officers and soldiers spend their entire lives in a single regiment and they naturally become blind to many of its faults.

26.16 Information that could tarnish the reputation of the regiment may be deliberately hidden and whistleblowers perceived as outside the military culture. The Board continued:

It is understandable that a soldier would want to keep any news of wrongdoing within his regiment ... in the military this concept of washing dirty linen *entre nous* can actually work against the chain of command if it is applied with too much rigour.

26.17 The Department has experienced a moral crisis during the last few years. The turmoil originated primarily from the incidents in Somalia involving the killing of civilians and subsequent allegations of cover-up, but public complaints and departmental investigations into misuse of public funds have added to the problem. Alleged abuses of resources — in, for example, renovation of official residences, hospitality and entertainment, use of aircraft, travel claims, environmental allowances — have involved both senior officials and personnel at lower ranks. In response, the government and the Department launched several initiatives that affected all departmental and Canadian Forces activities and personnel. These resulted in:

- a review of the Canadian Forces and a report to the Prime Minister on how to address problems of leadership, discipline, command and management and honour (*Report to the Prime Minister on Leadership and Management in the Canadian Forces*, March 1997);

- an assessment of the Code of Service Discipline and the roles and functions of the military police, including the independence and integrity of the investigative process (*Report of the Special Advisory Group on Military Justice and the Military Police Investigation Services*, March 1997);

- a review of the quasi-judicial role of the Minister as set out in the *National Defence Act* to ensure that the Minister of National Defence has maximum flexibility in conducting the affairs of the Department and the Canadian Forces and enhancing the impartiality of the military justice process (*Report on Quasi-Judicial Role of the Minister of National Defence*, July 1997); and

- an inquiry into the Somalia operation, including the chain of command, leadership, and discipline (*Report of the Commission of Inquiry into the Deployment of Canadian Forces to Somalia*, June 1997).

**Military organizations
may develop cultures
that can both reinforce
and conflict with
ethical values.**



National Defence Headquarters in Ottawa. Several initiatives were launched in response to the turmoil experienced by the Department and the Canadian Forces over the last few years (see paragraph 26.17).

26.18 On 14 October 1997, the Minister of National Defence established a Monitoring Committee on Change in the Department of National Defence and the Canadian Forces to ensure the implementation of some 279 accepted recommendations arising from these reviews. The Committee is to submit its final report to the Minister in the fall of 1999.

26.19 Part of the departmental response has been the establishment of the office of the Ombudsman. The Ombudsman was appointed in June 1998 after a period of extensive consultations and negotiations, a working mandate put in place a year later, June 1999. The mandate will be reviewed after six months of operations.

26.20 The Ombudsman's mandate defines his role as "an independent, neutral and objective sounding board, mediator and reporter acting as a direct source of information, referral and education to help individuals access existing channels of assistance and redress within the Department and the Canadian Forces." The Ombudsman also reviews internal processes to ensure that individuals are treated fairly and equitably. The mandate provides the Ombudsman with the authority to conduct investigations where necessary.

26.21 The Office of the Auditor General has long taken an active interest in issues of ethical conduct in the public service. Our May 1995 Report Chapter 1, Ethics and Fraud Awareness in Government, proposed an ethical framework for government. The chapter identified the need for a continuous process that highlights ethics in decision-making, a multi-faceted approach to strengthen the government's ethical climate and a heightened awareness among senior managers. Our September 1998 Report Chapter 15, Promoting Integrity in Revenue Canada, considered

the various means Revenue Canada uses to promote integrity among its employees.

26.22 Earlier audits also reflected our interest in the proper conduct of public business. Our May 1995 Report Chapter 7, Travel and Hospitality, identified government travel as a visible indicator of prudence and probity in the management of public funds; and Chapter 8, Travel Under Foreign Service Directives, reviewed action taken by Foreign Affairs and International Trade in response to irregularities in travel claims submitted by employees. Together, those audits looked at ethical awareness and stewardship of resources in travel by public servants.

Focus of the audit

26.23 Military police statistics indicate that cases of fraud and theft are relatively rare in the Department (Exhibit 26.3). We undertook this audit because our Office had received a number of serious complaints of abuse of resources at National Defence. At the start of our audit, departmental officials lacked the information to assure us that these complaints represented isolated incidents and not a general trend.

26.24 The focus of our audit was on the three steps that management must take to control the risk of fraud and abuse: the active support of ethical conduct, the maintenance of effective internal controls and internal audit, and effective follow-up on complaints. Our audit examined the implementation of the Defence Ethics Program, the key means by which National Defence supports ethical values and conduct. We also reviewed the adequacy of internal financial controls and internal audit at selected locations. Finally, we examined how the central special examination and inquiry unit of the Department has investigated complaints, and what corrective action has been taken. Additional details can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

Defence Ethics Program

Intended as a key response to ethical problems

26.25 In response to the growing need to re-emphasize ethical decision making and integrity in the Department, senior officials decided in February 1994 to develop an ethics program; they approved the result in December 1997. The philosophical foundation of the program is a “values-based” approach, which places priority on core values and principles of ethical culture as guides to professional conduct. The “values-based” approach to ethics was chosen for the Defence Ethics Program with the clear intent that it would be a comprehensive program implemented from the top down throughout the Department and the Canadian Forces.

26.26 The essence of the Department’s strategy is an organization-wide ethics statement, a centrally designed program and delegated responsibility for its implementation. The Chief Review Services, who heads the Department’s internal audit function, acts as the program authority in the Department. Headquarters group principals and navy, army and air force chiefs of staff are responsible for implementing the program in their respective services. An Ethics Advisory Board establishes a network of ethics co-ordinators appointed from each headquarters group and military service. Subordinate co-ordinators, or other implementation structures, are to be set up throughout the chain of command. The program’s challenge is to ensure that all departmental activities with an ethical dimension are consistent with the fundamental expression of defence values in the *Statement of Defence Ethics*.

26.27 The Department has chosen an approach intended to nurture

understanding and fundamental changes in behaviour, rather than a more mechanistic approach aimed at cycling large numbers of people through short training sessions.

26.28 The keystone document that serves as the program’s foundation is the *Statement of Defence Ethics* (Exhibit 26.4). This consists of two main parts: three ethical principles related to respect, service and obedience to lawful authority; and a core of six ethical obligations. The principles are intended to be universally valid aids for establishing priorities when ethical obligations conflict or when circumstances do not present

The Defence Ethics Program is intended to be a comprehensive program, implemented from the top down throughout the Department and the Canadian Forces.

Exhibit 26.3

Theft and Fraud Investigations Reported by the Canadian Forces Provost Marshal



Source: Department of National Defence

choices that are clear and ethically unambiguous. Ethical obligations are intended to be standards of conduct with equal weight that members of the Department should strive to meet in performing their professional roles and duties.

26.29 The Department's ethics strategy requires that the policy, expectations and

guidance be clearly communicated and leadership commitment be clearly seen. The strategy involves raising awareness, providing ethics training, promoting individual self-learning, and providing opportunities for discussion and open dialogue on ethics issues. Risk assessment is to be used to identify potential ethical problems.

Exhibit 26.4

The Department Has a Formal Statement of Ethics

Statement of Defence Ethics

The Canadian Forces and the Department of National Defence have a special responsibility for the defence of Canada. This responsibility is fulfilled through a commitment by the department and its employees, the Canadian Forces and its members to the following ethical principles and obligations:

PRINCIPLES

RESPECT THE DIGNITY OF ALL PERSONS
SERVE CANADA BEFORE SELF
OBEY AND SUPPORT LAWFUL AUTHORITY

OBLIGATIONS

Integrity

- We give precedence to ethical principles and obligations in our decisions and actions. We respect all ethical obligations deriving from applicable laws and regulations. We do not condone unethical conduct.

Loyalty

- We fulfil our commitments in a manner that best serves Canada, DND and the CF.

Courage

- We face challenges, whether physical or moral, with determination and strength of character.

Honesty

- We are truthful in our decisions and actions. We use resources appropriately and in the best interests of the Defence mission.

Fairness

- We are just and equitable in our decisions and actions.

Responsibility

- We perform our tasks with competence, diligence and dedication. We are accountable for and accept the consequences of our decisions and actions. We place the welfare of others ahead of our personal interests.



National Defence Defense nationale

Canada

26.30 All members of the Canadian Forces are to be exposed to a graduated program of ethics training, taking every advantage of existing programs and opportunities. At a minimum, the Department aims to provide basic, intermediate and advanced courses at appropriate career points. Training courses are to be linked with specifications of knowledge and skills required of officers and non-commissioned members. Communication activities at the workplace are to supplement formal training courses. Training in ethics is to be developed for civilian employees and the Department plans to introduce ethics training for them in core courses.

26.31 According to guidance provided in the Defence Ethics Program Implementation Handbook, ethics co-ordinators at the rank of colonel or the civilian equivalent are to be appointed within headquarters groups and military services to implement the Defence Ethics Program in their areas of responsibility. Ethics co-ordinators are responsible for providing guidance, advice and assistance in the program's implementation, providing referrals for advice on ethics issues, and participating as members of the Ethics Advisory Board.

26.32 Ethics co-ordinators are also responsible for monitoring and reporting on the accomplishment of the program's objectives in their own organizations. With the 1999–2000 business planning exercise, reporting responsibilities have been removed from the various headquarters groups and the military services and only the Chief Review Services now reports on the progress of the Defence Ethics Program.

The Defence Ethics Program has not yet been fully implemented

26.33 More than five years after the development of an ethics program was directed by the Defence Management Committee, key elements of the Defence

Ethics Program have still not been implemented in the Department. Although the program's development began in February 1994, the *Statement of Defence Ethics* was not completed until almost three years later. Establishing terms of reference and completing preliminary drafts of the *Implementation Handbook* took until late 1997. Eighteen months after its publication, the *Handbook* has not yet become departmental policy. Although a French-language version was completed in February 1998, the units we visited who work in French were unaware of the *Handbook*.

26.34 Moreover, the *Handbook* has been issued only informally to departmental staff. Of the 10 headquarters groups and military service headquarters with an ethics co-ordinator, two had not received a copy of the *Implementation Handbook*. Seven had copies that were outdated.

26.35 The terms of reference for the Defence Ethics Program do not include the clear reporting mechanisms that are provided for in the Department's other mandated programs such as the Standards for Harassment and Racism Prevention (SHARP) program. Although the Chief Review Services has been responsible since April 1999 for reporting on the Defence Ethics Program in departmental business plans, he has sent no reporting instructions to headquarters groups and the military services. Consequently, business plans do not report on the Defence Ethics Program. Officials told us that in their view the program is at a highly developmental stage, making it difficult to plan precisely or develop monitoring tools. We agree that at the program's inception there were few models to guide the Department. At this juncture, however, plans with clear goals and a monitoring system similar to other change programs appear both feasible and appropriate.

26.36 We found, moreover, that the lack of a departmental plan with specific

Senior military officials told us that — in spite of approved terms of reference — they had never been ordered to implement the ethics program.

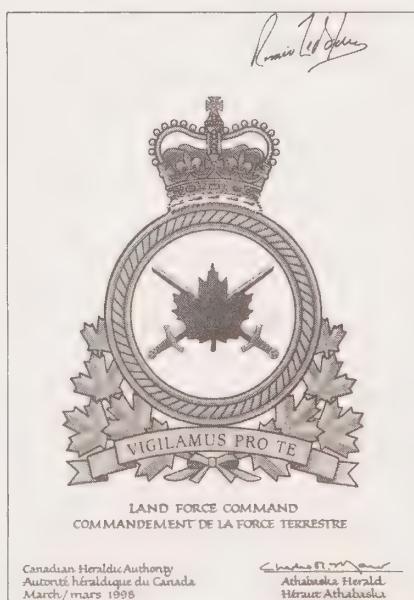
goals has led to uneven levels of commitment in the three military services. We were told by senior military officials from all three services that they did not believe they had ever been ordered to implement the Defence Ethics Program. This is in spite of the approval of terms of reference for the program by the Defence Management Committee — of which the Environmental Chiefs of Staff are members. Officials told us that they believed their services had always subscribed to appropriate ethical values and that their unique approaches were sufficient means to achieve departmental objectives. It is not surprising in these circumstances that implementation is slow. Moreover, a host of local value statements continue to form the basis of ethics instruction.

26.37 During the course of our audit, the Chief Review Services took a number of steps to improve program management. The *Defence Ethics Program 1999 Program Report*, published in August 1999, provides a comprehensive statement

of the central component of the ethics program. It contains concrete goals and objectives for some program elements. Officials told us a similar plan had been developed for the army. In addition, the Chief Review Services was conducting a baseline survey of employee attitudes and beliefs, although it had not yet been completed. What remains is to complete goals and objectives for the rest of the program and to incorporate the parts of program delegated to the military services and headquarters groups into departmental reporting.

The Statement of Defence Ethics competes with a plethora of statements and values

26.38 The *Statement of Defence Ethics* is not the Department's only statement on ethics issues. In the March 1997 *Report to the Prime Minister*, the Minister of National Defence recommended that a formal statement of values and beliefs be integrated into departmental activities by June of that year. The *Canadian Forces Ethos Statement* was subsequently



Senior officials from the navy, the army and the air force have always subscribed to the ethical values of their own service. They do not believe that they were ordered to implement the Defence Ethics Program (see paragraph 26.36).

approved by the Armed Forces Council in July 1997. The *Ethos Statement* was aimed at the Canadian Forces rather than the Department as a whole. It is intended to be a second “keystone” document addressing the Somalia Inquiry’s recommendations that the core qualities of military leadership, other necessary attributes and performance factors be the basis for leadership in the Canadian Forces.

26.39 Departmental officials acknowledge that the existence of two similar statements has been problematic and that their discussion inside the Department has been unclear at times. However, they believe that both statements are authoritative and do not conflict.

26.40 The Minister’s Monitoring Committee on Change in the Department of National Defence and the Canadian Forces noted in its 1999 *Interim Report* that it was difficult to gauge progress in the development and application of leadership standards because there appeared to be no master implementation plan. Similarly, we found that the choice by staff between the ethics and ethos statements as a basis for implementing the program has followed no consistent pattern. For example, nearly 90 percent of the courses we reviewed had ethics content of some sort but it was based on the *Statement of Defence Ethics* in only about 60 percent of them.

26.41 We also identified a plethora of statements and values used in addition to the *Statement of Defence Ethics*. In more than 30 different source documents we identified around 100 different values intended to guide the conduct of operations and activities in the Department and the Canadian Forces (Exhibit 26.5). The source documents ranged from the officer’s commission to army doctrine and referred to values such as a sense of humour, veracity and willingness to admit mistakes. According

to departmental officials, this is a sign that the individual services and branches are implementing the overall program. Nevertheless, the range of the various statements means their focus is inconsistent, even if they do not actually conflict with each other.

The Defence Ethics Program has not been fully integrated into formal human resource management systems

26.42 The Defence Planning Guidance for 1997, 1998 and 1999 provided specific directions for implementing the “mandated” Defence Ethics Program. We therefore expected to find the *Statement of Defence Ethics* or other elements of the program reflected concretely in training courses and in formal elements of human resource management such as performance appraisals. This requirement was in the Minister’s military *Ethos Statement*. Due to the confusion in the Department over the two statements, departmental reporting tends to mix the two initiatives.

26.43 The appraisal process. We found that criteria for promotions vary from one promotion board to another. It was not possible, therefore, to assess the impact of the Defence Ethics Program on the promotion process. However, we were able to assess the place of ethics in the performance appraisal process. New systems are still in draft form, but we note that the new system for appraisal of non-commissioned members and officers up to lieutenant-colonel does not include ethics as a specific element. The old system had such provisions for officers up to the rank of brigadier-general. Moreover, guidance issued by the Chief of the Defence Staff for senior officer appraisals refers to ethical factors taken from *La Relève* (published by the Privy Council Office) instead of from the *Statement of Defence Ethics*. There are no ethics provisions in the civilian appraisal system which is a public-service wide system and not specific to National Defence.

During the audit we identified more than 30 statements used in addition to the Statement of Defence Ethics.

Exhibit 26.5

Ethics Statements and Values Listed in Various National Defence Documents

Sources	
Report to the Prime Minister: Ethos and Values in the Canadian Forces	Canada's Army – We Stand on Guard for Thee (CFP 300)
Report on the Recommendations of the Somalia Commission of Inquiry – A Commitment to Change	Land Force Strategic Direction and Guidance 1998 – Parts I & II
Officer's Commission	Canadian Forces Base Petawawa – The Principles of Leadership
Royal Military College's interpretation of Officer's Commission	2 Canadian Mechanized Brigade Group (2CMBG) – Commander's Operating Plan 1999/2002
Royal Military College (RMC) Values	Strategic Operations and Resource Plan 1998/1999 and 1999/2000
Statement of Defence Ethics (SDE)	Combat Training Centre (CTC) Gagetown – Tactics Course
Revised Statement of Defence Ethics (SDE)	Combat Training Centre (CTC) Gagetown – Armour Course
Chief Review Services (CRS) Business Plan 1999/2000	Combat Training Centre (CTC) Gagetown – Leadership Development
Judge Advocate General (JAG) Business Plan 1999/2000	Land Force Central Area (LFCA) – Canadian Military Ethos
1997 Defence Planning Guidance (DPG)	Armed Forces Council – The Ethos of the Canadian Forces
Canadian Forces Provost Marshal (CFPM) Annual Report – 1998	LFCA Business Plan 1998/1999 and LFCA 1999/2000 Operating Plan
Evaluation Reports for Senior Officers	LFCA Commander's Guidance 1998
Adjusting Course – A Naval Strategy for Canada	Chief of the Air Staff (CAS) – Basic Aerospace Operations Course
Maritime Command – Guide to the Divisional System	1 Canadian Air Division (1 CAD) Business Plan 1998
Navy videos	8 Wing (Trenton) – Officer General Specifications (OGS – 6/98)
Base Halifax Leadership Seminar 1998	8 Wing (Trenton) – Interview with Officials

Values			
Accountability	Ethics	Make sure that your followers know your meaning and intent, then lead them to the accomplishment of the mission	Respect the dignity of all persons
Achieve professional competence	Excellence	Maintain political & interpersonal neutrality	Respect for rule of law
Act in public interest	Fairness	Medical code of ethics	Responsibility
Adhere to laws of war and regulations of the CF	Faithful to subordinates	Military is subordinate to civilian authority	Seek and accept responsibility
Allow no discrimination, ill treatment, or cruelty	Fitness	Moral conviction	Self-discipline
Appreciate your own strengths and limitations and pursue self-improvement	Generosity	Mutual respect	Selfless service
Avoid conflicts of interest	Good conduct	Obedience	Selflessness
Awareness	Good judgment	Obey and support lawful authority	Sense of humour
Believe in Canada	Honesty	Openness	Serve Canada before self
Care for our people	Honour	Padre/Chaplain's code of ethics	Service
Carefully discharge duty	Honour commitments	Patience	Service to Canada
Commitment	Honour memory of those who died in service of Canada & those who fought and survived	Patriotism	Team before individual
Compassion	Human Resources code of ethics	Perseverance	Teamwork
Competence	Humanitarianism	Physical robustness	Technical knowledge
Courage	Initiative	Precision and conciseness	Timeliness
Decisiveness	Integrity	Pride	Tolerance
Dedication	Intellect	Professional knowledge	Train your soldiers as a team and employ them up to their capabilities
Defend legal Constitution	Justice	Professionalism	Trust
Desire for peace	Keep your followers informed of the mission, the changing situation and the overall picture	Prudence	Truth
Determination	Know your soldiers and promote their welfare	Recognition	Unlimited liability
Develop the leadership potential of your followers	Knowledge of others	Representativeness	Uphold personal, social and ethical norms
Dignity	Knowledge of self	Respect & uphold the customs & traditions of the CF & of own and other services	Valour
Diligence	Lawyers' code of ethics	Respect for others	Veracity
Discipline	Lead by example		Visits
Duty	Loyalty		Welcome strength that diversity brings
	Make sound and timely decisions		Willingness to admit mistakes

26.44 Training. Training is the major formal vehicle for communicating values and developing judgment. We looked at the content of 80 career courses identified by the Department as requiring an ethics module under the Defence Ethics Program (see Exhibit 26.6). Only 24 percent of the courses contained an ethics module detailing the full training standards and plans required by the Canadian Forces Training System or equivalent standards for professional development courses. Another 18 percent had ethics modules that met standards in part. This situation could be explained by the fact, as noted in paragraph 26.36, that the military services do not feel obliged to implement the program.

26.45 Ethics training is now focussed on entry-level military members and officers and is making some progress. Of 5,700 officer and non-commissioned member recruits, about 3,900 were taught the *Statement of Defence Ethics* in their entry course. In the Canadian Forces as a whole, about 13,000 members have

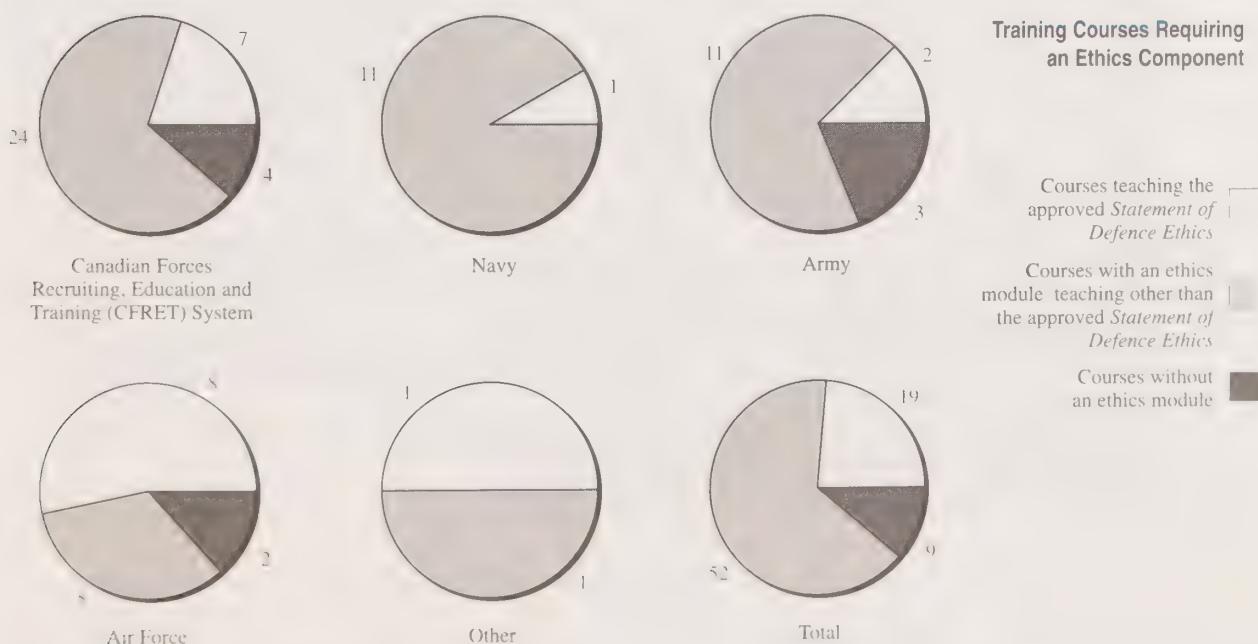
attended a course with an ethics component since 1997, but only about 8,600 of these have attended a course whose ethics component was based on the approved *Statement of Defence Ethics*. The Department has not identified the number of military members who still require formal ethics training or how long it will be before they are all trained.

26.46 General Officer Ethics Focus Group Sessions. Executive leadership is considered an area of particular importance in the Defence Ethics Program. The Department has therefore held General Officer Ethics Focus Group Sessions to promote discussion of the ethical dimension of generalship, continue enhancing ethics dialogue, and further contribute to ethics awareness at the strategic level. All general officers were invited to participate in the three sessions held between June 1998 and May 1999 and to submit short examples of ethical dilemmas. We found that only about 25 percent of individuals appointed during this period to rank of general or flag

The Department is making good progress in entry-level ethics training. However, training needs to give more priority to older and more senior members who act as role models.

Exhibit 26.6

Training Courses Requiring an Ethics Component



officer had attended a focus group session. However, the Chief Review Services staff have included all general officers by sending them preliminary questionnaires and informing them about the results of the sessions.

The ethics co-ordinator network has not been adequately implemented

26.47 As we have noted, the Defence Ethics Program is to be managed through a network of ethics co-ordinators; the Chief Review Services recommended that they be colonels or the civilian equivalent. Where ethics co-ordinators have been appointed, we found that they are often at more junior levels, reporting to middle rather than senior management. They have been given no specific training, although it is planned for 1999–2000. The ethics co-ordinator in the Vice Chief of the Defence Staff Group was unaware that his role extends to the office of the Chief of the Defence Staff.

26.48 Of the 10 headquarters groups, four have developed an implementation strategy for the program in at least draft form. However, there has been no significant progress in developing implementation plans.

Status of the program

26.49 Overall, we found that implementation of the Defence Ethics Program has been slow; the *Implementation Handbook* is still in draft form and various editions are being used; no reporting mechanisms are in place; co-ordinators are at lower ranks than recommended; and most implementation strategies exist only in draft form or not at all. (An overview is provided in Exhibit 26.7.) Leadership in implementing the Defence Ethics Program is not being adequately demonstrated by the military chiefs of staff. Progress has been made in the training of new entrants to the Canadian Forces, but higher priority needs to be given to ethics training of mid-level and senior officials who act as role

models. As yet, no specific goals or targets have been established to implement the program. The apparent low level of commitment within the three services creates the risk that the program will not advance as quickly as it should and that, as a result, the status quo will continue. Certainly, unless more leadership is shown at the top it is very unlikely that a uniform approach will be created and put in place consistently throughout the Department and the Canadian Forces.

26.50 National Defence should implement the Defence Ethics Program as quickly as possible, clarifying responsibilities, and approving plans with defined goals. It should also monitor the program.

Department's response: This Department is fully committed to the importance of ethics and values. To capitalize on the significant accomplishments made to date, we will continue to progress with timely implementation of the Defence Ethics Program consistent with its vision and strategy. Recognizing the unique nature and implementation requirements of a value-based ethics program, the Department will re-emphasize responsibilities and assist managers to formalize plans. We will continue to assist and work closely with the Treasury Board Secretariat Office of Values and Ethics in the recently announced government-wide initiative.

Internal Controls and Internal Audit

Departmental control systems are needed to support ethical behaviour

26.51 The environment in which National Defence operates is rapidly changing and it is essential that the Department identify, manage and control the risks this presents. Control systems, which are designed to ensure compliance with policies and regulations, can provide an overview of strengths and weaknesses.

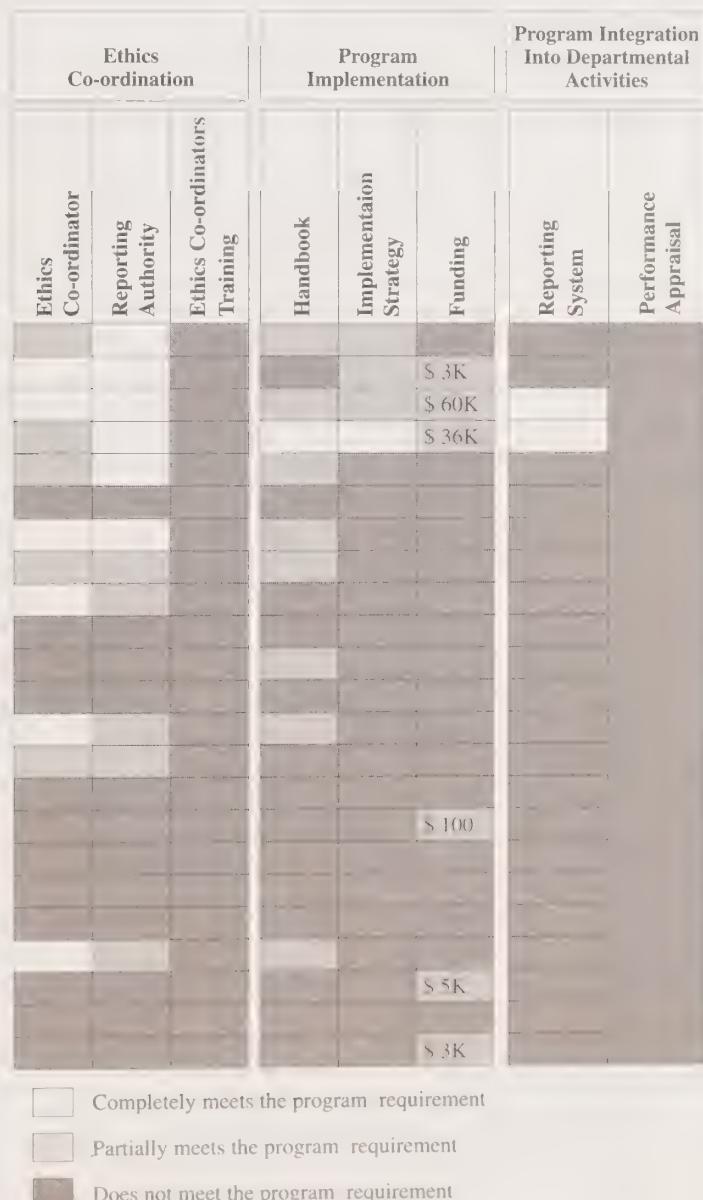
To be effective, controls must help managers respond to situations in a consistent way, achieve their established objectives, prevent or detect mistakes and avoid embarrassment.

26.52 Resource reductions, increased financial delegation and the adoption of

operating budgets have significantly affected the extent to which managers at all levels can be involved in the management of defence resources. At the same time, some control mechanisms have been eliminated. Responsibilities and associated resources have been delegated

Exhibit 26.7

Implementation of the Defence Ethics Program in National Defence and the Canadian Forces (April 1999)



Reductions in resources have meant increased managerial delegation while fewer resources are available for control.

to the managers who directly control specific activities. This decentralization has meant that more people have financial responsibilities, and this increases the need for new tools and support to assess internal controls.

26.53 While the timing, nature and location of controls can change, they will continue to be important and necessary. Our audit looked at key departmental control systems, including management of internal controls and military police services.

Internal audit resources have declined

26.54 Like all functions in the Department, the audit function has been affected by downsizing in recent years. According to the Chief Review Services Business Plan, the departmental “audit community” numbered about 133 in 1998–99, down from approximately 330 in the early 1990s. This is a 60 percent decline, compared with a 35 percent decline in full-time employees overall. However, the staff of the critical Chief Review Services group was reduced only by about 30 percent and the branch retained most of its previous budget.

26.55 Each military service is responsible for its own review staff. Except for the Chief Review Services, who has not yet had to do major staffing, all units/bases/formations in our sample had been unable to fill vacant audit positions. Because these are now classified as junior to mid-level civilian positions, the Department seems unable to attract and keep good candidates.

26.56 In response to the increasing and changing demands for review services, the Department has decided to modify its audit approach and focus more on broad-based audits than on audits of compliance. While compliance issues continue to be covered in every audit, they are now just one component of a comprehensive review process. This represents a move from relying solely on

compliance auditing to reviewing management systems and measuring performance. Officials told us that they believe that traditional, compliance-based approaches are unaffordable and that new methods can do a better job.

26.57 While corporate review is still considered important, review services have had to reallocate resources in response to the significantly increased responsibilities of line commanders and managers. Resources have been transferred from audit teams to provide “review assistance” to managers and leaders. This type of support activity represents roughly 20 percent of auditors’ work. Although it is not unusual for internal audit to devote this much time to support, it leaves a smaller portion of already scarce audit resources for independent audit work based on assessed risks.

26.58 In the case of the Chief Review Services, the proportion of resources allocated to assistance is forecast to decline to 6 percent in 1999–2000, making a greater proportion available for audit. In addition, 4 of 16 assistance projects undertaken by the Chief Review Services since 1997–98 were in response to complaints of abuse of resources.

26.59 These changes mean that internal audit units at the military service level are conducting fewer audits. However, control self-assessment sessions have been initiated to complement traditional approaches to review and audit. Control self-assessment is a process that assists managers in identifying their areas of potential risk and assessing the strengths and weaknesses of their controls.

26.60 The Chief Review Services, who co-ordinates and monitors the control self-assessment process, informed us that 59 sessions were held from September 1997 to May 1999, with 10 to 15 participants at each session. This means that the process has covered only a very small percentage of the Department’s responsibility centres. This first

assessment of risks is very important, but it is only a preliminary step in the audit cycle and no substitute for independent audit. The Chief Review Services Branch told us it hopes to use the results of these assessments along with audit work to develop a control assessment of the entire Department. However, it did not provide us with a date for its expected completion or any other targets for this undertaking.

26.61 The Department has made some initial efforts to address the risk of fraud and abuse directly. The Chief Review Services, in partnership with the Canadian Forces Provost Marshal and other Headquarters staff, held a one-day conference in May 1999 to discuss developing a strategy for protecting resources. The Land Force Central Area has also developed a fraud prevention policy and handbook. The development of a national fraud and abuse policy is now under way.

Most local audit groups do not assess risk systematically in preparing audit plans

26.62 Each year, the Chief Review Services prepares a risk assessment to identify priority areas for audit and review. In addition, several of the audits it undertakes provide extensive risk assessments of such major functions as local procurement and supply, base-level support services and operating budgets. Overall, the assessments have identified many areas of risk but the Chief Review Services has not been able to follow up on most. Indeed, at the end of 1998–99 there were still 36 audit projects under way and over 30 areas identified for future audit planning.

26.63 We found that audit units belonging to the military services themselves did not use adequate risk assessment techniques. Very few audit units at the sites we visited could provide us with risk assessments and annual audit plans, although most were in the process

of preparing their annual plan for 1999–2000. Apart from one completed by Maritime Command Pacific, risk assessments were essentially based on personal experience or on a “gut feeling”. Only one of the units we visited used formal risk assessment in its audit planning.

Managers believe that risk is increasing

26.64 While organizational change is taking place and the new management framework (business planning, devolution of responsibilities, resource allocation and accountability system) is being implemented, managers have to assume an increased amount of risk. From 1995 to 1998, the Vice Chief of the Defence Staff and the Assistant Deputy Minister (Finance and Corporate Services) conducted Comptrollership Reviews in the three armed services to verify the effectiveness of the comptrollership framework and practices throughout the Department. Information about comptrollership practices was gathered through interviews with senior leaders, comptroller staff and resource managers. Their reports gave a good indication of the concerns that commanders and managers have about their increasing vulnerability to risk as a by-product of the new management culture. Their perception is that devolution of authority and responsibility to lower levels increases the risk. The fact that the Department's ethics and values program has not been fully implemented and accepted by employees also acts to increase risk. Given that organization-wide risk assessment is performed infrequently, internal audit is not a position to inform senior management of the nature and extent of risk. In particular, it is unable to assess risks in areas that are not covered by internal audit.

26.65 Most managers identified the lack of dedicated local audit capability as a major impediment to their willingness to assume more risk. Managers are generally uncomfortable with the low level of

We found few completed risk assessments at command and unit sites included in our audit. Most assessments we reviewed were based on experience and a “gut feeling”.

The Department's Comptrollership Reviews have identified the lack of local internal audit as a major impediment to managers' willingness to assume more risk.

assurance now provided by local review services, and several indicated that they would prefer to see more audits of their financial transactions.

26.66 The air force has carried out very few audits in the last five years. There was no audit function in most wings while 1 Canadian Air Division's audit capability was in an embryonic phase. The capability of the air force to conduct reviews, audits and examinations has been weakened to an unprecedented degree. In the opinion of the Commander of 1 Canadian Air Division, the air force is no longer meeting the intent of Treasury Board policy or the expectations of the Deputy Minister. The air force has recognized this deficiency and is now hiring auditors.

Local audit work could be improved

26.67 With management practices and controls now decentralized, a corporate internal audit function is more relevant than ever before. However, internal audit in the three services is not co-ordinated with internal audit at National Defence headquarters. The army has a liaison person who essentially serves as a channel of communication between the Chief Review Services and the army areas and who provides guidance on internal audit policy. The navy has a small group working on internal audit guidance and also ensuring communication with the Chief Review Services. Apart from annual meetings of internal auditors, there are no real mechanisms in place to ensure good communication on a regular basis among the various internal audit units. Local internal audit units do not report their results to headquarters, nor are they required to consider national audit findings in their own audit planning. Due to lack of staff, the air force review services group in Ottawa is more involved in the management and investigation of complaints than in auditing.

26.68 In general, we found that local internal audit resources have declined.

Systematic risk analysis is not being used to apply the remaining resources to the highest priorities. Managers are becoming concerned that the risks they are taking are too high. This key element in the prevention of abuse is therefore weak. Without adequate internal controls and internal audit, management creates an environment in which some employees may be tempted to violate ethical standards.

26.69 **The Department should ensure that risk assessments are conducted and that audit resources are assigned commensurate with the risk identified.**

***Department's response:** Chief Review Services, the central review group within the Department, will extend its risk analysis in support of audit planning to include and assist the plans of the audit resources working within the individual military services. This will ensure that total audit activity is appropriately applied in accordance with assessed risk. The central audit group has a strong automated data analysis capability and is developing techniques to periodically analyze transaction trends and patterns in order to identify irregularities. This will be particularly critical as e-commerce progresses. Pertinent training in these techniques, including those aimed at fraud awareness, will also be provided to local audit resources.*

26.70 **Environmental Chiefs of Staff should ensure that their internal audit activities are co-ordinated with those of the Chief Review Services at headquarters.**

***Department's response:** As indicated, the Chief Review Services will take the lead in co-ordinating audit plans within the Department. This is consistent with the Chief Review Services' responsibility for corporate-level review and for advising the Deputy Minister and Chief of the Defence Staff on all review matters. The DND/CF Intranet will be used as a vehicle for the sharing of audit information, reports and work plans. This, combined*

with direct interaction, will increase the degree of co-ordination. Such co-ordination has already been achieved in a principal element of review work at the local level, that being the workshops conducted by audit staff to assist managers in self assessing and remediating their controls.

Management's Control Systems Have Weakened

Local management is concerned about weaknesses in financial management systems

26.71 Management cannot rely solely on internal audit as a control. Audit only validates the effectiveness of other controls. It relies on managers to provide proper accounting and control mechanisms. All managers have a responsibility to manage with prudence and probity the resources allocated to them for their programs. Responsible managers establish inspection mechanisms to provide assurance that directives and guidelines are complied with and that spending is within approved levels and for approved purposes.

26.72 The Deputy Minister of National Defence has stated certain expectations of financial managers in the Department's Financial Management Accountability Framework document. This is a significant step in raising line managers' awareness of financial responsibility. Senior managers are now required to sign an annual letter of Financial Management Attestation. The letter attests that financial management responsibilities have been fully satisfied and that systems and processes in place meet the needs of the command or headquarters group.

26.73 In all locations we visited, officials told us that the shortage of personnel has caused extensive delay — if not abandonment — of most types of compliance inspection schedules. The navy has maintained as a priority the inspection of ships that are considered at

higher risk, but it has postponed or changed the cycle of shore inspections. Neither the army nor the air force has been able to complete its 18-month cycle of financial inspections.

26.74 In addition, the new responsibility framework means that standard checklists are no longer accurate; this hampers the examination process. Directives need to be modified to reflect operational realities. There have been discussions at army headquarters about issuing new directives for service-level inspections, but at June 1999 no changes had yet been made.

26.75 Inspection responsibilities have been delegated in many cases to the unit level, so that individuals are virtually exercising control over themselves. Yet a departmental policy requires that officers who conduct inspections of a function not have direct responsibility for managing the function.

26.76 There is evidence that financial controls have weakened in some areas. Our audit did not establish whether the situation is worsening overall, or exactly how widespread the violation of control

Resources for internal financial compliance checks are inadequate to complete annual inspections, and checklists are out-of-date. Staff carrying out financial inspections are not independent of the areas they have reviewed.



Due to shortage of personnel, the army and the air force have not been able to complete their 18-month cycle of financial inspections at Canadian Forces bases like this one (see paragraph 26.73).

has been. We did find, however, that some types of breakdown were mentioned frequently in departmental reports and by managers we interviewed. Some examples follow:

- **Cashier operations.** Cashier operations were deemed by comptrollers to be unsatisfactory in many locations. In one formation, a review of cashier operations revealed that the cashier had not balanced his accounts for several months, yet no action was taken. In fact, this situation was allowed to continue, which seems to indicate a lack of proper communication up and down the chain of command. Officials told us that the problems had been caused by the implementation of the new financial management system over the last 18 months and had now been corrected.

- **Ensuring that payments are made correctly.** In conducting compliance audits, a comptroller discovered that staff had not complied with the section of the *Financial Administration Act* that requires the purchasing manager to certify that goods or services have been received before payment is made. The comptroller noted that this certification had either been performed by individuals who lacked

the necessary authority or had been omitted entirely. Because of changes to the financial management information system, some employees did not fully understand their responsibilities.

- **Acquisition cards.** “Acquisition cards” are government credit cards. Through a compliance audit, a comptroller found that in certain areas an appropriate authority (that is, someone other than the cardholder) had not authorized acquisition statements. The acquisition card is a tool that allows greater flexibility in purchasing everyday, low-risk items. As a result, however, many units believe incorrectly that some of the old rules, such as the requirement to report any item over \$1,000 to the unit’s distribution account, have changed or been eliminated.

- **Travel by senior officials.** Internal audits found that contrary to regulations, senior officials were routinely travelling without the approval of their superiors. In spite of the Department’s efforts to stop this practice, we found that it still occurs to a significant extent.

26.77 Audits have revealed important problems that could be a concern to most of the units in the Department. Senior managers sign attestation letters to provide assurance to the Deputy Minister that financial management requirements have been met. However, those letters have often included the qualification that there were limits on the managers’ capacity to assume responsibility for authorities and funds entrusted to the unit. At the wing level in the air force, for instance, commanders have said they have serious concerns about signing their attestation letters when they lack audit resources to provide assurance of compliance.

26.78 Central financial managers told us they believe that the Comptrollership Reviews and the attestation letters are a step forward in creating awareness and in identifying problems. We agree. Nevertheless, the financial control

There is evidence that financial controls have weakened.



Financial clerk responsible for cashier operations. Many comptrollers think cash control is unsatisfactory (see paragraph 26.76).

problem appears to be significant and concerted effort is needed to resolve it.

Departmental audits indicate increasing risk of fraud and abuse

26.79 Downsizing and re-engineering of the Department have also affected non-financial functions. The Chief Review Services has conducted several audits and reviews. One audit of local procurement and supply found that roles were no longer clearly defined and that management assistance visits and internal audits had been substantially curtailed or eliminated altogether. In the opinion of the internal auditors, local materiel management was subject to very little monitoring of any kind. The results were an increased opportunity for theft and abuse of public materiel, reduced compliance with government and departmental regulations, less-than-optimal value for money, reduced accuracy of inventory and lack of effective control over high-risk transactions. Inappropriate behaviour was rarely detected by management controls; it was usually reported to the military police by third parties.

26.80 Other Chief Review Services audits of base support and management of operational budgets indicate a probable similar situation in other functions. A draft audit report of base support pointed to the effects of downsizing and reorganization of Canadian Forces bases as leaving managers without the tools and resources to manage risk effectively. It called for a formal risk management process at both the base and national headquarters levels. The draft audit report of the management of operational budgets found that there were few consequences for those who broke rules and guidances unless they crossed the boundary into criminal activity.

Systematic abuses have escaped detection

26.81 The Department has been victimized by at least one widespread,

systematic abuse, with secret commissions and kick-backs involving numerous Canadian Forces and civilian Defence employees. This case is discussed more fully in the Other Audit Observations section of this Report. It should also be noted that the Department was previously informed of this matter but closed its investigation as unsubstantiated. This case is of interest because it demonstrates the need for improved controls and internal audit.

26.82 **The Department should reinstate its management checks of compliance, consistent with assessed risk, to reduce the likelihood of fraud and abuse of resources.**

Department's response: Departmental internal audits have emphasized particular control risks associated with devolution and affecting the current period of transition to the delivery and full utilization of new technologies. Risk analysis will be undertaken under the leadership of the central internal audit group, in conjunction with the introduction of a DND/CF Fraud Awareness initiative, and will take advantage of automated data retrieval and analysis to guide and assist increased compliance review at the local level.

Reform of the military police is ongoing

26.83 During the last two years, the military police faced major challenges in responding to the report of the Somalia Commission of Inquiry, and the report of the Special Advisory Group on Military Justice and Military Police Investigation Services. Both reports raised concerns about the independence of the military police and the transparency of their investigations.

26.84 In response to these reports, the Director General Security and the military police were restructured to form the Canadian Forces Provost Marshal, who is accountable to the Vice Chief of the Defence Staff for maintaining police

Commanders are signing financial attestation letters — but not without reservations.

Headquarters internal audits confirm that controls have weakened, local internal audit is absent and the risk of fraud and abuse has increased.

standards. The Provost Marshal is responsible for developing policies and plans common to the three services and for providing specialized and investigative services to the Canadian Forces. The National Investigation Service is independent of the operational chain of command and investigates matters of a “serious or sensitive nature”. These may be broadly defined as allegations involving individuals at the rank of major or above, involving \$10,000 or more in losses or indictable offences under a federal statute or the *National Defence Act*.

26.85 The Provost Marshal’s investigative and crime prevention responsibilities are aimed at preventing and detecting abuse and misuse of resources. Complaints about significant misuse or abuse of resources are to be brought to the attention of the National Investigation Service by the complainants or by the local military police. The investigators are to be independent from the normal military chain of command.

26.86 For other than “serious and sensitive” matters, the investigation process is relatively unchanged and investigations are usually performed at the unit level by local military police. Boards of inquiry and summary investigations are commonly used to investigate incidents of an administrative nature. Cases of unusual significance or complexity are brought to a board of inquiry. In both cases, the process is used to determine the facts; and the convening authority evaluates the findings and determines whether administrative or disciplinary action is indicated.

26.87 The National Investigation Service has the authority to lay charges if its investigations show that they are warranted. Commanding officers may decide to proceed or stay those charges. Similarly, commanding officers may choose to take no action on reports of boards of inquiry and summary

investigations. Any party not satisfied with the result has recourse to grievance procedures.

26.88 This process is meant to give the chain of command the ability to use administrative and disciplinary action as necessary in order to maintain good order and discipline within units. It is used at each level of command and can always be moved to higher levels when more independence is required.

26.89 Changes to the *National Defence Act*, in December 1998, created a Military Police Complaints Commission with the power to investigate and report publicly on not only complaints of police abuse but also police complaints of improper interference in their investigations. At the time of our audit, members of the Complaints Commission had been appointed and were establishing their office. The Commission is scheduled to begin work in December 1999.

The new police structure needs refinement

26.90 It is important that the chain of command not be seen to unduly influence the law enforcement duties of the military police. With the creation of the National Investigation Service, commanders lost their jurisdiction over courts martial: “serious and sensitive cases” are now handled by the Provost Marshal. However, it appears that some commanders do not yet understand how the new system is to work. Monitoring by the Canadian Forces Provost Marshal has found the following:

- A commander did not accept direction on police standards issued by the Provost Marshal as a result of an audit of the local military police.
- A base commander issued a policy without authority to do so. The policy directed that the base security officer consult the commanding officer before seeking a search warrant from local authorities to conduct police searches.

This policy interfered with police independence.

- A commanding officer issued a directive indicating that, although not a legal requirement, all persons involved in an incident would be cautioned or informed of their rights. Such action could limit people's willingness to talk to the police by implying that they were about to be charged.

26.91 The Vice Chief of the Defence Staff is responsible for ensuring that everyone in the chain of command understands the role of the military police, and for ensuring the independence of the police. Continuing review by the Canadian Forces Provost Marshal is in place to ensure that police standards are being met. In addition, in order to correct the current situation, the Department planned by November 1999 to train 1,700 officers to preside over summary trials.

26.92 In summary, we believe the Department needs to resolve two emerging problems as it implements improvements to its police forces. First, it needs to ensure that its commanding officers understand how the system is intended to work and their role in it. Second, the Military Police Complaints Commission needs to be brought into operation rapidly to ensure that the system functions as designed.

26.93 To ensure the independence of the military police, the Department should strengthen its training of commanders so that they better understand their role in the military justice system.

Department's response: The Department will reinforce the role of commanders in the military justice system by distributing communication packages on the reforms stemming from Bill C-25 (under way), completing Certification Training for all delegated officers (under way) and

activating the Military Police Complaints Commission (expected December 1999).

Following Up Complaints of Abuse

The Department has specialized staff to investigate abuses

26.94 In June 1992, the Department created the Directorate of Special Examinations and Inquiries to investigate allegations or instances of impropriety, mismanagement and other irregularities in the Department and the Canadian Forces. The Directorate reports to the Chief Review Services. Reports are sent to the Deputy Minister or the Chief of the Defence Staff, the most senior officials of the Department.

26.95 We reviewed complaints that our Office had received and had referred to the Department since 1995, and also complaints that the Deputy Minister and the Chief of the Defence Staff had assigned to the Directorate since its inception. Of the cases we reviewed, 45 had been dealt with by the Directorate of Special Examinations and Inquiries, 17 were complaints made to the Chief Review Services and the remaining 12



Military Police officer exercising some of her duties under the responsibility of the chain of command (see paragraph 26.90).

were complaints made to the Minister's Office, the Deputy Minister, the Chief of the Defence Staff, the Assistant Deputy Minister (Personnel) or the Assistant Deputy Minister (Finance and Corporate Services). We focussed on the process for assessing the validity of allegations and on the corrective and remedial actions taken by the Department. We expected that any such actions would be timely.

26.96 We identified three general categories of behaviour (other than waste) that diverged from the proper conduct of public business:

- abuse of public funds — public resources were used in a way that produced little or no public benefit;
- abuse of policies and regulations — individuals claimed or accepted benefits contrary to the intent of policy; and
- dishonesty — laws or policies were intentionally circumvented to benefit the individuals involved.

The Department did not take satisfactory corrective actions in 6 of 26 cases.

The Department considered more than half the allegations to be valid

26.97 We reviewed a total of 74 cases related to abuse of public funds or to violation of conflict-of-interest or post-employment codes. The Department had completed assessments of 66 of those cases and the 8 remaining were still being assessed at the time of our audit. The Department had concluded that the complaints were valid in 40 of the 66 cases. Examples of complaints that the Department believes were well founded are shown in Exhibit 26.8. Exhibit 26.9 summarizes our findings.

Not all allegations were assessed adequately

26.98 In 12 of the 66 cases completed by the Department, we found that assessments had not been done, not completed or not documented. Six of these cases had been dealt with by the Minister's office or by senior officials

such as the Deputy Minister's office and the Assistant Deputy Minister (Personnel) rather than by the Chief Review Services.

Corrective action has sometimes been incomplete

26.99 We considered the Department's corrective actions to be satisfactory when they were fully implemented and corrected the identified problem. The Department had judged that corrective action was warranted in 26 of the 66 cases we reviewed and that no corrective action was required in 32 cases. In the 26 cases where the Department took corrective action, we consider the action to be satisfactory in 18 cases and to represent significant progress in 2 others. In our view, its action in the remaining 6 cases was not satisfactory.

26.100 On two complaints we had referred to the Department, officials informed us that corrective action had been taken. However, we found that this was not the case.

Remedial action is taken in most cases

26.101 When a problem is confirmed, remedial actions are taken in order to prevent similar problems from occurring elsewhere in the Department. In 28 of the 66 cases we assessed, the Department concluded that remedial actions were required; we believe one additional case warranted remedial action because of the risk of recurrence at other locations. In only 9 cases did the Department take satisfactory action and develop the control system that was needed. In 13 cases its action represented significant progress, while in 4 cases little progress was made. In 3 cases, the Department did not take satisfactory action.

26.102 We noted that in many cases the Department's remedial action consisted of amending its current regulations — most often those pertaining to travel and relocation and to the delegation of travel authority. The Department found in several cases that its regulations or

Examples of Complaints the Department Considered Well Founded

Claim for meals provided free of charge

Incident: Two allegations were made that officials had claimed reimbursement for meals that had already been paid for by other organizations. In both cases, the Department concluded that the claims for meal allowances violated the spirit and intent of the ethics policy.

Corrective action: In one case, departmental legal services advised that no specific regulation was violated and therefore they could not support the recovery of the money from the officials involved. In the other case, the Department reviewed all claims and requested that officials return the payments for unauthorized expenses.

Remedial action: Memoranda were sent throughout the Department on several occasions to clarify departmental regulations on this matter. After two years, amendments to departmental regulations and practices are still being developed.

Renovations to an official residence

Incident: An allegation was made that renovations to an official residence were excessive. After the review, the Department concluded that renovations had been ordered by a senior official without proper authorization and that while most of the work was required, could not conclude whether all of the renovations were necessary.

Corrective and remedial action: No corrective or remedial action was recommended.

Damage to departmental property and harassment of a military police official

Incident: Allegations were made of a cover-up by the chain of command and of interference with a police investigation. This is a case where a senior official had damaged National Defence property. The Chief Review Services reviewed the cover-up allegation and concluded that the decision process that had been followed was in accordance with normal procedures. It is noted that the Chief Review Services was not tasked with assessing the adequacy of corrective action taken. In addition, a professional standards investigation was conducted into the allegation of interference and it concluded that the complainant police official had been the victim of intimidation, abuse of authority and other inappropriate actions by senior officials.

Corrective action: Senior officials involved were briefed on the findings of the investigations. One officer was also provided with guidance and education. The complainant police official was ordered to change work location and to attend training courses. The senior official who damaged the property received a verbal warning.

Remedial action: No remedial action was identified by the Department.

Irregular activities on National Defence property

Incident: An allegation was made that a senior official solicited on National Defence property on behalf of his business and that the chain of command did not act appropriately when made aware of the situation.

Corrective action: The Canadian Forces Provost Marshal believed that charges could have been initiated against the senior official in question. However, a departmental legal advisor concluded that the evidence was insufficient to demonstrate a reasonable prospect of conviction. Nevertheless, the chain of command took administrative measures. The senior officer involved received counselling and probation and his direct superior received a recorded warning.

Remedial action: The scenario was submitted as a case for discussion at future ethics seminars.

Use of public funds for non-public organizations

Incident: An allegation was made that officials used personnel resources to serve non-public organizations. The Department acknowledged the use of these resources in some cases.

Corrective action: No corrective action was identified by the Department.

Remedial action: After three years, actions such as amendments to departmental regulations on this matter are still under way.

policies had been unclear, not understood, or inconsistent with government regulations. In many instances, the Department undertook interim measures to resolve the issue temporarily, but the measures remained in effect for long periods of time. Interim measures included issuing memoranda to either clarify or temporarily amend a regulation. Such methods are ineffective, as staff tend to forget or lose the memoranda.

The Department does not follow up on a timely basis

26.103 We found that the time taken by the Department to assess an allegation and fully implement any necessary corrective and remedial actions could involve significant delays. Our population of 74 cases consisted of 39 that were completely followed up by the Department, 19 incomplete cases in which the assessment, corrective action or remedial action was still in progress, and 16 cases in which either no assessment

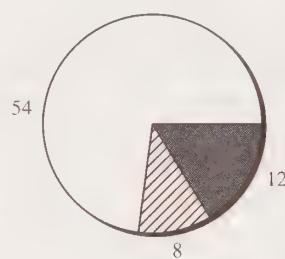
was done or we could not obtain sufficient data to form an opinion. Twenty-five of the 39 completed cases were finished within a year, but others took over two years and 2 cases took more than 3 years. When incomplete cases are included, 16 have already taken more than a year and 9 of those are three years old or more (Exhibit 26.10). The following cases are examples of our concern:

- In June 1996, the Department determined that parking fees should be charged at one of its locations. When this location closed in May 1998, parking fees had never been introduced.
- In May 1996, the Department determined that the departmental regulation on the use of military personnel in non-public organizations should be amended. Senior officials informed us in April 1999 that the amendments to the regulation were still under way.
- In August 1997, the Department determined that amendments to its

Exhibit 26.9

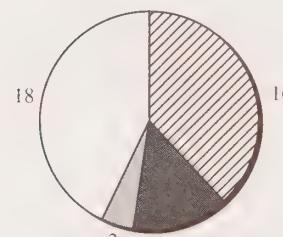
Following Up on Complaints of Abuse

- Adequate
- Assessment still ongoing
- Inadequate

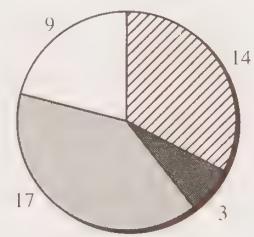


Assessment of the validity of allegations
(74 cases)

- Satisfactory
- Progress made
- Unable to conclude
- Unsatisfactory



Corrective actions
(42 cases)



Remedial actions
(43 cases)

Note: Of the 74 cases, corrective and remedial actions were not required in 32 and 31 cases respectively.

policies governing military travel were needed. It took an interim measure in February 1999 by communicating through a memorandum that it had concerns about those policies. Additional interim direction has been provided by the Deputy Minister and the Chief of the Defence Staff. A new departmental regulation was to be developed over the next year to provide clear and consistent direction in line with government policy.

26.104 In order to deter fraud and abuse, the Department should ensure that all complaints are followed up promptly.

26.105 The Department should ensure that all complaints are tracked with the objective of completing them within one year of their receipt.

26.106 The Chief Review Services should follow up on corrective and remedial actions to determine whether they have been completed and have resolved the problems, and report his findings to the Deputy Minister.

Department's response: The Department agrees that complaints directed to the highest management levels of the Department should be followed up promptly and assessed in a timely manner. Complaints that warrant criminal investigation will continue to be addressed by the Canadian Forces Provost Marshal. Those complaints not warranting criminal investigation will be referred to the Chief Review Services. Complaints referred to the Chief Review Services are now being tracked and the Department is confident that assessments will generally be completed within one year. The Department will follow up on corrective and remedial actions to determine when they have been completed. These findings will be reported regularly to the Deputy Minister and to the Chief of the Defence Staff. The Auditor General can assist by ensuring that the Chief Review Services is made aware of all complaints that are passed to the Department for resolution.

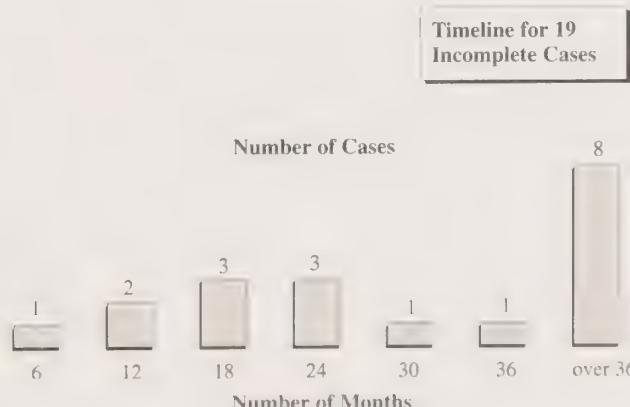
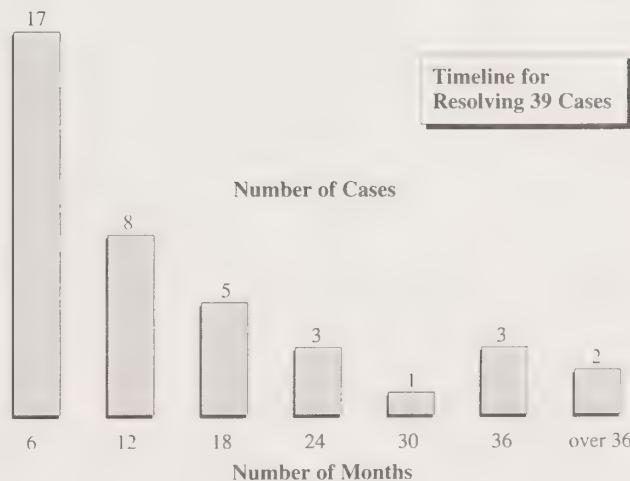
Conclusion

26.107 National Defence has put in place basic measures to ensure the proper conduct of public business in each of the areas we audited — active support of ethical conduct, internal control and internal audit, and follow-up on complaints. However, each of these areas requires further improvement.

26.108 The Defence Ethics Program is the supportive, proactive element of the Department's measures to support ethical conduct. The design of the program is appropriate for that purpose and the

Exhibit 26.10

Overall Cases Resolved



Department has achieved significant progress in training new entrants into the Canadian Forces at all ranks. However, headquarters groups and the three military commands do not believe that a uniform program is appropriate. Staff have confused the Minister's *Ethos Statement* with the *Statement of Defence Ethics*, and the latter has been formally implemented only sporadically in training and human resource management systems. Nominal budgets, a failure to appoint senior-level ethics co-ordinators and an absence of plans indicate that the level of commitment to a formal ethics program across the organization is low.

26.109 The effectiveness of internal financial controls and internal audit, two standard deterrents and detectors of fraud and abuse, has been severely limited by budget cuts. Reductions have not been planned on the basis of adequate risk assessment, so the Department is unable to say what levels are actually needed. It appears that resources devoted to internal audit are below productive levels. There are troubling signs that financial and other controls have weakened; chief among

them is commanders' reluctance to attest to their effective control of resources.

26.110 Finally, complaints referred to the senior management of the Department have not all been handled adequately. Almost one fifth of the cases we reviewed had not been assessed or were assessed inadequately. In over one fifth of the cases where the Department judged that corrective action was warranted, it did not take satisfactory action. Actions needed to remedy systemic problems were completed in over three quarters of the cases we reviewed. While the cases do not statistically represent all complaints throughout the Department, the fact that they were handled by senior officials at headquarters makes these results disappointing.

26.111 Most of the basic elements the Department needs to move forward are in some stage of development. Senior management now needs to assess risks systematically, develop a plan and exercise strong leadership in implementing it throughout the Department.



About the Audit

Objectives

Our audit objectives were to:

- assess whether National Defence responds appropriately to complaints of abuse of resources or misconduct;
- determine the extent to which the Defence Ethics Program responds to problems brought to light by complaints; and
- assess whether internal audit and other review functions in the Department respond to the risk of fraud and abuse.

Scope

Our audit was based on a general model of what needs to be done to reduce the risk of fraud and abuse in any organization. The model consists of three parts and we conducted audit work in each:

- *Communication of appropriate values.* Rules cannot govern every eventuality or controls be in place in every situation. Management must therefore takes steps to convince employees to comply with the norms of acceptable behaviour.

Our audit examined the extent to which the keystone departmental values program — the Defence Ethics Program — had been implemented throughout the Department.

- *Internal controls and internal audit.* Internal controls are the processes and measures put in place by management to help prevent and detect both error and employee misconduct. Internal audit provides the Department's management with an independent evaluation of certain aspects of its operations.

We examined internal financial controls at selected Canadian Forces bases. We assessed internal audit at headquarters, within the three military services, and at selected Canadian Forces bases. We did not audit other types of internal controls, such as those governing materiel.

- *Appropriate corrective action.* When employee misconduct is identified, appropriate action must be taken to investigate and apply discipline. Subsequently, internal controls may have to be modified to prevent recurrence of the same problem, or other measures such as training may be needed.

Our audit reviewed the assessment and follow-up on 74 cases assigned to the headquarters Directorate of Special Examinations and Inquiries since 1992, and complaints received by us from the public and referred to the Department for action since 1995. We did not audit allegations that complainants had referred to the military police or to management directly.

Our audit was conducted at National Defence headquarters and at major formations in each service: Maritime Forces Atlantic, Maritime Forces Pacific, Secteur du Québec de la Force Terrestre, Land Force Central Area, and 1 Canadian Air Division. At the base level we audited Canadian Forces Bases Halifax, Esquimalt, Valcartier, Petawawa, Winnipeg and Trenton.

Criteria

We expected that:

- departmental plans and policies for the Defence Ethics Program would be consistent and resources would be assigned commensurate with plans;
- all activities with an ethical component, such as training, would be consistent with the Department's fundamental statement of values;
- control systems would be designed to ensure that adequate corrective actions are taken when required;
- internal controls and internal audit would be resourced commensurate with the assessed level of risk;
- complaints of abuse would be assessed for validity on a timely basis;
- where control weaknesses are identified, appropriate remedial actions would be taken on a timely basis; and
- disciplinary actions would be in accordance with Treasury Board regulations and Queen's Regulations and Orders.

Audit Team

Assistant Auditor General: David Rattray

Principal: Peter Kasurak

Director: Pierre Hamel

Andrée Bélair

Sylvie Blais

Lori Buck

Anne Hardy

Jean-Michel Langlois

Haleem Mughal

Darlene Mulligan

Denise Rita

Stéphane Rousseau

For more information, please contact Peter Kasurak.

Chapter 27

National Defence

Alternative Service Delivery

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Main Points

27.1 The Alternative Service Delivery (ASD) program at National Defence — a search for new and better ways of providing government services — is still in its early stages and has made gains at a slower rate than the Department had initially expected. Unconfirmed departmental estimates suggest that savings are currently about \$68 million. Given the Department's \$3.5 billion annual expenditures on support services, considerable scope for savings remains. In 1996 it projected that annual savings would reach \$200 million by 1999. Based on results to date, however, the Department has revised this projection to \$175 million a year by 2004.

27.2 Many of the business case analyses for the 14 projects we audited were poorly done. Options were not always adequately assessed or the best option chosen. Personnel appeared to lack the necessary skills to undertake analyses. The Department has taken steps to improve its management of more recent ASD projects and believes it has corrected the earlier shortcomings.

27.3 The government lacks an adequate policy framework for “partnering” with the private sector and contracting out large service programs. In particular, the \$2.8 billion NATO Flying Training in Canada contract:

- was let without competition, contrary to government contracting policy and regulations, thus forgoing the benefits of price competition; and
- did not follow Public Works and Government Services Canada’s profit policy and guidelines for sole-source contracts, and profit markups were not supported by adequate analyses.

27.4 Inflexible contract arrangements resulted in payments for unused training capacity. For example:

- The Meaford Area Training Centre is operated under a \$40 million five-year fixed-price contract. However, it was used at only 43 percent capacity in 1998.
- The Canadian Aviation Training Centre, Portage-la-Prairie operates a flying training program under a \$165 million contract; it was substantially underutilized during the first six years.

Background and other observations

27.5 According to National Defence, the aim of its ASD program is to provide a framework for departmental managers to pursue best value for the defence dollar in non-core activities. Through the program, it hopes to identify and use the most cost-effective ways of delivering support services, which constitute about one third of the Department's \$10.3 billion budget. We noted that many of the activities being considered for the ASD program have already achieved savings through downsizing and re-engineering.

27.6 When the Department launched the ASD program in 1995, it set a goal of saving \$200 million a year by 1999 and \$350 million a year by 2001. We audited 14 of its 40 active ASD projects. We audited only government actions and our observations imply no criticism of any third party supplying services to the government.

The responses of National Defence, the Treasury Board Secretariat and Public Works and Government Services Canada are included in this chapter. National Defence is taking action to address all our recommendations. In particular, the Department is devoting a higher level of management attention to ASD projects and ensuring that staff are adequately trained.

With respect to our concern about the lack of an adequate policy framework for “partnering” with the private sector, the Treasury Board Secretariat and Public Works and Government Services Canada are currently participating in an interdepartmental initiative to reform procurement that will include, among other matters, work on guidance for large, multi-year service contracts.

National Defence believes that the NATO Flying Training in Canada program is innovative and will provide good-quality pilot training at a lower cost than the current training system or any other training option in the foreseeable future.

Introduction

The 1994 Defence White Paper called for major cuts in defence spending

27.7 In 1994 the government issued a revised defence policy that directed National Defence to operate with fewer resources, fewer people and less infrastructure. The policy also called for the Department to adopt better business practices and continue seeking new ways to support the operational forces. In-house support activities were to be transferred entirely to Canadian industry if business case analyses demonstrated a potential for increased cost effectiveness, or shared with private industry under various partnership arrangements.

27.8 To implement the 1994 policy direction, National Defence developed a comprehensive five-year renewal plan containing five key elements: downsizing, infrastructure rationalization, management renewal, better use of information technology, and alternative service delivery (ASD).

27.9 Alternative service delivery is a term that refers to a systematic search for new and better ways of providing government services. The government-wide policy on ASD is contained in a Treasury Board Secretariat guidance document issued in 1995, entitled *Framework for Alternative Program Delivery*. That document sets out basic principles and criteria for assessing whether and how the delivery of government programs, activities, services and functions could be changed to better meet government objectives or provide better value. Departments are expected to deliver programs and services as efficiently as possible, whether with in-house staff and resources or through an external supplier. This approach needs to be based on a good understanding of outputs, levels of service and costs of delivery. According to the Treasury Board policy, alternative means of program

delivery should cost not more and preferably less than traditional methods.

27.10 The aim of the National Defence ASD program is to provide the framework within which the Department's managers pursue best value for the defence dollar in non-core activities. Best value is determined through business case analyses of available delivery options.

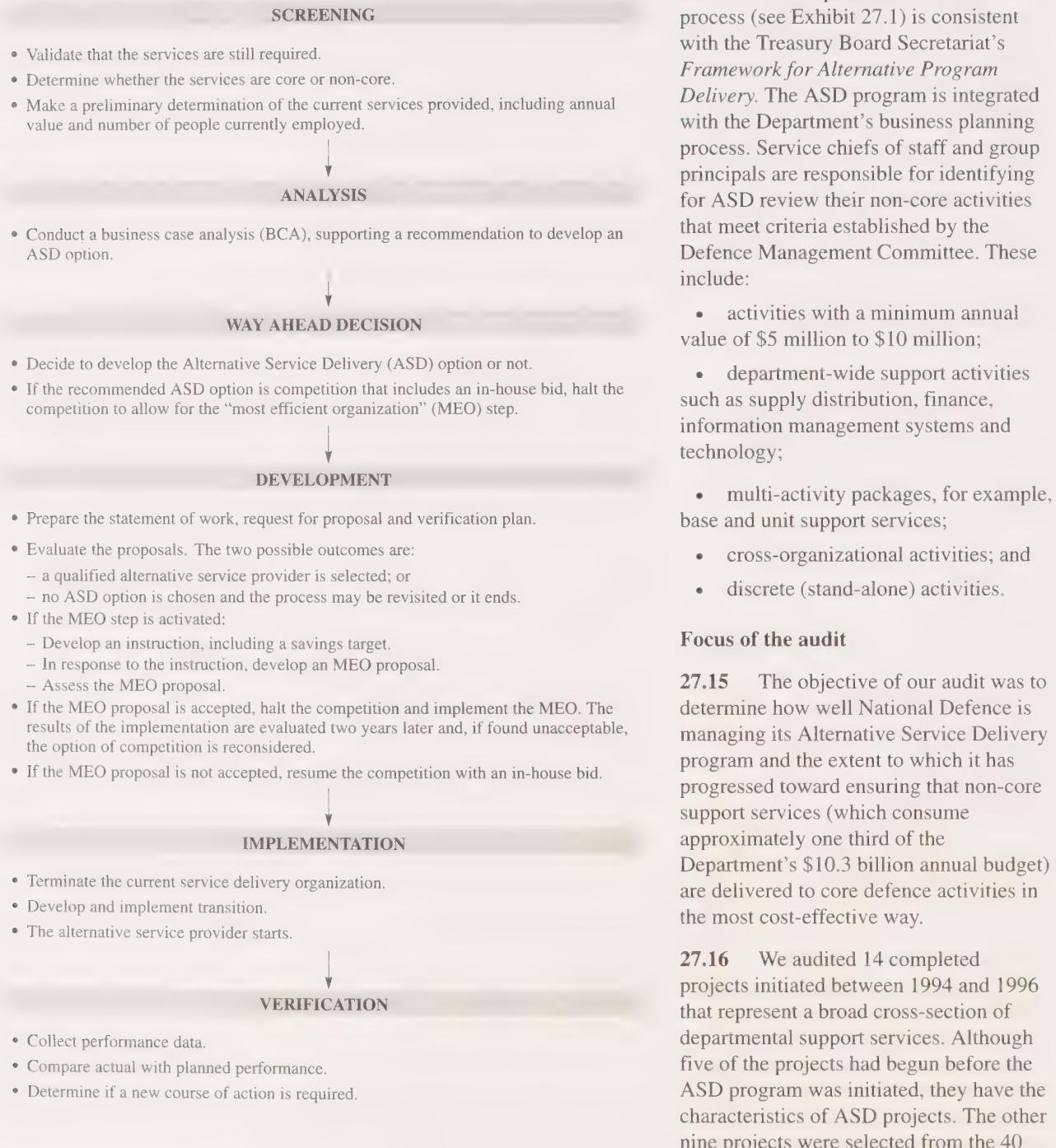
Alternative service delivery policy and program structure

27.11 In November 1996, the Department issued a guide to applying the ASD methodology in order to assist managers in selecting the best ways to conduct non-core activities and deliver internal services.

27.12 Centrally managed ASD projects are under the executive authority of the Deputy Minister and the Chief of Defence Staff. Other ASD projects are under the executive authority of commanders and group principals. The Vice Chief of the Defence Staff (VCDS) oversees the ASD program and the centrally managed projects, supported by a steering committee at the assistant deputy minister level with membership from unions, Treasury Board Secretariat, Public Works and Government Services Canada and independent brokers. Other steering committees support commanders and group principals for specific projects under their executive authority. An ASD directorate under the VCDS and the Director General Management Renewal Services provides central policy direction and guidance, develops methodologies and processes, co-ordinates the identification of ASD projects, provides facilitation services to commands and groups and monitors and reports on the progress of ASD activities.

27.13 Moreover, commanders and group principals each have an ASD co-ordinator for the ASD reviews in their areas. These co-ordinators are the primary points of contact for information about individual ASD reviews. Each ASD

The Alternative Service Delivery (ASD) program provides the framework within which the Department's managers pursue best value for the defence dollar in non-core activities.

Exhibit 27.1**Overview of the Alternative Service Delivery (ASD) Process**

review is managed and implemented by its own project team, reporting to the executive authority through a steering committee.

27.14 The Department’s ASD review process (see Exhibit 27.1) is consistent with the Treasury Board Secretariat’s *Framework for Alternative Program Delivery*. The ASD program is integrated with the Department’s business planning process. Service chiefs of staff and group principals are responsible for identifying for ASD review their non-core activities that meet criteria established by the Defence Management Committee. These include:

- activities with a minimum annual value of \$5 million to \$10 million;
- department-wide support activities such as supply distribution, finance, information management systems and technology;
- multi-activity packages, for example, base and unit support services;
- cross-organizational activities; and
- discrete (stand-alone) activities.

Focus of the audit

27.15 The objective of our audit was to determine how well National Defence is managing its Alternative Service Delivery program and the extent to which it has progressed toward ensuring that non-core support services (which consume approximately one third of the Department’s \$10.3 billion annual budget) are delivered to core defence activities in the most cost-effective way.

27.16 We audited 14 completed projects initiated between 1994 and 1996 that represent a broad cross-section of departmental support services. Although five of the projects had begun before the ASD program was initiated, they have the characteristics of ASD projects. The other nine projects were selected from the 40 reviews of support service activities that National Defence has undertaken since

introducing the ASD program in 1995. Exhibit 27.2 lists the projects selected for audit; a brief description of each is provided in the Appendix to this chapter.

27.17 We audited the following aspects of the ASD program:

- the strategic framework;
- the analytical framework (business case analysis);
- human resource management; and
- contracting.

Further information on our objectives, scope and criteria can be found in the section **About the Audit**.

Observations and Recommendations

Achievement of Savings Slower Than Expected

27.18 In our 1996 audit of support productivity in National Defence, we noted that the Minister's goal was to produce the defence capabilities described in the 1994 Defence White Paper with 25 percent fewer resources. We reported that to meet this goal, the Department needed to improve the productivity of its support services. The ASD program and the Department's re-engineering initiative are part of its efforts to improve support

Exhibit 27.2

Alternative Service Delivery Projects Audited

ASD Project Name	External Contract	Service Agreements	Retained Current Arrangement	Annual Budget (\$ millions)
Project Genesis*				700.0
NATO Flying Training in Canada (NFTC)*	X			140.0
Fleet Maintenance Facilities – East and West			X	85.0
Canadian Aviation Training Centre*	X			33.0
Military Pay*			X	33.0
Goose Bay Support Services	X			27.0
Auxiliary Fleet Operations and Manning – East and West			X	14.0
Meaford Area Training Centre*	X			13.4
Automated Test Equipment CF-18	X			12.0
Aerospace Engineering Test Establishment			X	11.0
Munitions Experimental Test Center – Nicolet	X			11.0
Food Services Trenton		X		3.4
National Defence Headquarters Facilities Management			X	2.6
Publications Depot			X	2.5
Total				1,087.9

* These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

National Defence estimates that projects so far have resulted in approximately \$68 million in annual savings, far short of the \$200 million originally expected by 1999.

service productivity and increase cost effectiveness.

27.19 This audit focussed primarily on the ASD program, although in many cases re-engineering is an essential element of the ASD process — particularly when in-house teams are bidding for a contract to provide services. Our 1996 audit indicated that while re-engineering had been under way for several years, productivity had actually declined in some areas. In testimony before the Public Accounts Committee, senior departmental officials stated that implanting cost-consciousness and a more businesslike approach in National Defence would require a cultural change and would take a considerable period of time. Our current audit found that the needed change is not yet complete.

27.20 The Canadian Forces are sustained by a national support system that provides personnel support, equipment, food, fuel, maintenance and training. Since 1994, National Defence has been pursuing a comprehensive renewal effort in order to allocate more of its resources to defence operations and less to support functions. The ASD program is an important element of this renewal effort. In May 1996, the Defence Management Committee (DMC) estimated that the ASD program would result in annual savings of \$200 million by 1999, increasing to \$350 million by 2001.

27.21 Due to delays in implementing the initial list of 18 ASD initiatives and a slower-than-expected pace in identifying additional ASD projects, the Department has revised its projection of ASD savings to \$175 million a year by end of the planning period 1999–2004.

27.22 We were unable to verify the actual savings achieved in any of the ASD projects we audited. Most have not been established long enough to measure cost savings. Further, baseline costs had not been established for a number of the projects, and, in a number of others, we

could not satisfy ourselves that the estimates of baseline costs were comprehensive and accurate.

27.23 The 40 ASD reviews begun to date cover support activities that employ over 16,000 civilian and military personnel. The annual budget for these activities is about \$1.3 billion, less than half the total value of all non-core support services that were or could be potential candidates for ASD reviews.

27.24 By June 1999 the Department had completed 18 ASD reviews of support services whose annual budgets total about \$202 million. Defence officials now estimate that alternative delivery of those services will realize recurring annual savings of about \$68 million. This is approximately 30 percent of the \$200 million target for 1999, established when the ASD program was initiated in 1995.

Other defence organizations are also having difficulty achieving savings targets

27.25 We compared the Department's experience in implementing its ASD program with experience in the United States, the United Kingdom and Australia, where defence departments are implementing similar programs. We found that these countries are also encountering delays in implementing their contracting-out programs and are having difficulty achieving their initial savings targets.

27.26 **United States.** The U.S. Department of Defense has conducted studies of public/private competitive sourcing for commercial activities that affect over 200,000 military and civilian positions. Based on the results, it established an ambitious savings target of approximately \$11 billion between fiscal years 1997 and 2005. However, recent studies by the General Accounting Office have questioned whether the projected cost savings could be achieved by outsourcing. U.S. Defense officials have

also indicated that budget reductions and downsizing of civilian personnel in recent years could make its savings projections difficult to achieve.

27.27 Australia. The Australian Department of Defence implemented its Commercial Support Program (CSP) in mid-1991. The CSP identifies non-core activities and exposes them to competitive tendering. It offers industry the opportunity to compete for some work previously done exclusively by military and defence civilian personnel. Early estimates indicated that savings from CSP could be in the region of \$350 million a year. In 1996, after five years of the program, the Australian Minister of Defence indicated that progress had been far too slow and that the program had achieved annual savings of \$121 million a year. In July 1998, the Australian National Audit Office reported that the Department of Defence was claiming annual savings of \$155 million — about half the initial estimate. The report also noted that actual savings were difficult to determine because the Department's financial systems lacked the ability to track savings.

27.28 The United Kingdom. The United Kingdom Ministry of Defence, which has been operating the Competing for Quality Program since 1992, is reporting estimated savings of £366 million a year. This is equivalent to some 22 percent of the previous total annual operating cost of these activities, although no figures on actual savings are available. The Ministry of Defence sought to maximize the benefits of Competing for Quality through tighter arrangements for profit sharing and pricing, changes in workload, and better management of inventories. A 1996 study conducted by the Cabinet Office's efficiency unit looked at the program across the government and analyzed the first three years, 1992–93 to 1994–95 inclusive. It estimated net savings (taking into account the estimated costs of the Competing for Quality process) at between 13 and 15 percent,

although no figures on actual savings were available.

27.29 Based on experience in other countries, it appears that National Defence's initial projections of savings may have been overstated. Caution should be exercised in making estimates about the overall savings the program can achieve.

Business Case Analyses

27.30 As part of the methodology for conducting ASD reviews, the Department's ASD policy requires that business case analyses be prepared to support all ASD decisions. The business case is to contain a broad range of information that must be considered before the decision is made to outsource the delivery of a non-core support activity or retain it in-house.

27.31 While we audited several projects that predate the ASD policy, the requirements for business case analysis are basic and represent due diligence in the expenditure of government funds. We therefore expected that projects undertaken before the policy was issued would demonstrate the same level of care as the others in our sample.

27.32 We found that business case analyses had been conducted in 8 of the 14 projects selected for our audit, and not conducted at all in 4 projects. We were unable to audit business case analyses for the 2 remaining projects because the information was not available.

27.33 We assessed the business case analyses using the following criteria contained in the Department's *Costing Handbook*:

- the aim of the business case analysis, the key assumptions and constraints should be established, understood and articulated;
- the level of service should be sufficiently defined;

Business case analyses were completed in only 8 of the 14 projects we audited.

- the baseline costs of the support service activity should be established;
- .critical success factors should be established in advance to measure the extent to which feasible options meet desired objectives;
- each feasible option developed should be assessed against the capability and willingness of the marketplace to provide the service, including the

existence of competition in the marketplace;

- feasible options should be subjected to detailed cost and risk analyses; and
- the best option should be determined based on an analysis of quality, risk and cost effectiveness.

Exhibit 27.3 provides a summary of our findings on the 14 projects we audited.

Exhibit 27.3

Overview of Business Case Analyses

Project	Aim	Level of Service	Baseline Costs	Success Factors	Feasibility of options	Adequacy of options analysis	Selection of best option
<i>Contract service out to industry</i>							
NATO Flying Training in Canada (NFTC)*							
Goose Bay Support Services (GB)	■	■	■	■	■	■	■
Automated Test Equipment CF-18 (ATE CF-18)			■				
Munitions Experimental Test Centre (METC) – Nicolet		N/A					
Meaford Area Training Centre*	■	■	■	■	■	■	■
<i>Contract awarded to in-house bid</i>							
Food Services Trenton							
Publications Depot – CF (Pubs Depot)							
<i>Retain current arrangement</i>							
Fleet Maintenance Facilities (FMF) – MARPAC/MARLANT	■						
Military Pay*							
Auxiliary Fleet Operations and Manning – MARPAC/MARLANT	■						N/A
Aerospace Engineering Test Establishment (AETE)	■	■		■		■	
Project Genesis*		■			N/A	N/A	N/A
 Not met  Mostly not met  Mostly met  Fully Met							

* These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

Canadian Aviation Training Centre and NDHQ Facilities Management are not shown here because we were unable to conduct an analysis due to unavailability of data.

The aim was clear in most cases

27.34 In the project files that contained a formal business case analysis, a clearly stated aim was included. However, we could not find a formal analysis for Goose Bay Support Services, the Meaford Area Training Centre, the Aerospace Engineering Test Establishment or the NDHQ Facilities Management project. We found a number of associated studies, some of which partially addressed our audit criteria; however, none was comprehensive enough to constitute a business case analysis.

The existing levels of service were unspecified

27.35 Comparing present service delivery with an alternative form requires knowledge of the quantities, qualities and costs of existing service levels. We found that existing service levels had been known in only three projects. For the others, analysts had to develop the information using historical data. This task consumed significant internal staff time and funds for external consultants.

27.36 In the case of the Fleet Maintenance Facilities, the decision was to retain the current method of service delivery until fundamental issues of capability and capacity are resolved.

27.37 Neither the Aerospace Engineering Test Establishment nor the Meaford Area Training Centre had established service levels before the ASD reviews.

27.38 In the Auxiliary Fleet Services, neither the East nor the West Coast unit had established service levels. However, as part of the business case analysis, the analysts did develop past levels of service from historical records and data. Both East and West Coasts are still in the process of establishing service levels for tug operations.

27.39 At the Department's request, we reviewed Project Genesis, an Air Force

multi-project effort to preserve a viable fighter force by making force reductions and reducing support costs. We found that costs had been reduced substantially by various means, the greatest portion by reducing the size of the fighter fleet and the North Warning System. However, we are concerned that the air force did not — and still does not — have adequate measures of readiness and sustainment to ensure that reductions in flying hours will not reduce air force capabilities below the required levels. This means that the full impact of these changes cannot be determined.

Establishing baseline costs for existing support services proved difficult

27.40 We found that some project teams had difficulty developing baseline costs. Support service activities are almost always funded by more than one budget; for instance, the Fleet Maintenance Facilities use funds from the budgets of the Assistant Deputy Minister (Materiel), Maritime Forces Atlantic and about eight other units of Canadian Forces Base Halifax. The use of numerous funding authorities inevitably makes it difficult to develop baseline costs.

27.41 In the Goose Bay project, the decision to contract out support services was not based on a sound analysis of in-house costs. In order to evaluate all feasible alternatives, ASD methodology requires that baseline costs be established in advance. We found that baseline costs were rigorously established only after the decision had been made to submit support services to competition.

27.42 Departmental publications claim that the operation of the Meaford Area Training Centre, opened in July 1995, has been an ASD success story. The changes to Meaford originated in a departmental program that predated the ASD program. Although we did find a study that predated the opening of the Centre, it did not adequately define the baseline cost as derived from similar training operations.

Service levels and baseline costs continue to be difficult to establish. The full impact of change cannot be determined.

Two separate costing studies on Meaford highlight the difficulties in developing accurate baseline information when there have been significant changes in service delivery levels. Studies by both departmental staff and external consultants found it difficult to determine whether savings had been achieved. A study completed in May 1999 contained estimates ranging from annual savings of \$800,000 to a loss of \$300,000, depending on the assumptions made. Officials agreed that the training centre is larger than required, but estimates of the costs of unused capacity varied widely.

27.43 For the NDHQ Facilities Management project, it would appear from the very limited information provided to us that baseline costs were incomplete. This will make it difficult to determine cost savings.

Success factors were defined for most projects

27.44 The success objectives of the ASD initiative were to be clearly defined and were to include one or more of the following goals: increased efficiency; increased cost-effectiveness; improved quality of service; and improved work environment.

27.45 For most projects we examined, the business case did define the critical success factors against which feasible options were compared. However, we did not find any predefined success factors for the Meaford Area Training Centre and Goose Bay projects.

The feasibility of options was not always assessed

27.46 The capability and willingness of the marketplace to compete for a service contract must be assessed to determine if it is sufficient to warrant a change to alternative service delivery. While the market was assessed in many of the projects, in some it was not.

27.47 The \$2.8 billion NATO Flying Training in Canada project was initiated when National Defence received an unsolicited proposal in late 1994 from a private sector firm to provide a NATO flying training program. This proposal eventually became the preferred option. Options for the future Canadian Forces pilot training system had been defined in the spring of 1994 for further study, and informal discussions with the contractor had taken place for at least seven months before the unsolicited proposal was received. NFTC was added to the options in May 1995. Once it had reviewed the NFTC proposal, National Defence did not explore the level of competition that existed in the marketplace. In October 1997, the Treasury Board approved a submission by Public Works and Government Services Canada on behalf of National Defence for a non-competitive contract with Bombardier Inc. to deliver the program. Although there was probably insufficient time between the unsolicited proposal and NATO's deadline for the government to tender the project, we have concerns about the decision to sole-source, which are outlined in the case study on page 27-15.

27.48 The ASD process for the Aerospace Engineering Test Establishment proceeded to competition even though a 1995 market feasibility study had concluded that there was limited market demand for the use of the facilities involved. The negative implications of the market feasibility report were not properly reflected in subsequent decision making. This is significant, given that the ability of a contractor to successfully market spare range capacity was an essential component of the deal put forward by National Defence.

The options analyses for some projects were inadequate or incomplete

27.49 We expected to find that each feasible option identified would be assessed for its qualitative strengths and weaknesses, costs and risks. We found that

(continued on page 27-18)

Case Study – NATO Flying Training in Canada

Background

The NATO Flying Training in Canada (NFTC) program is an undergraduate and postgraduate military pilot training program offered by the Government of Canada, in co-operation with industry, to NATO and other nations seeking affordable military flying training solutions. NFTC is viewed by National Defence as a co-operative approach to training military jet pilots, based on a partnering between government and industry. Canadian and NATO air force pilots will provide the flying instruction. The industry team, led by Bombardier Inc. Defence Systems Division, will provide the aircraft, training simulators, training material, airfield and site support services, aircraft maintenance services and other services. Under the terms of the contract, the military fighter pilot training program will be made available to the Canadian Forces as well as to the military air forces of other nations who choose to participate. Since the NFTC project was initiated prior to the implementation of the ASD program, it is not being managed under the ASD management framework.

In addition to the primary objective of developing a cost-effective pilot training program, NFTC is supposed to achieve a number of other benefits. These are:

- creating employment;
- keeping the base at Moose Jaw open;
- demonstrating the capabilities of Canada's aerospace industry; and
- making a significant contribution to NATO.

Officials also informed us that National Defence had insufficient capital funds to renew its training aircraft fleets. One of the ways to combat the "rust out" of the existing fleet was to implement a service contract that required annual installment payments.

In 1996, National Defence obtained Cabinet approval to enter into a 20-year, \$2.8 billion sole-source contract with Bombardier Inc. to provide support to the NTFC. The legal relationships underlying this arrangement are complex and interdependent. The flight training will take place at Canadian Forces Base Moose Jaw and the base in Cold Lake. The government has licensed the use of these bases to Milit-Air Inc., an independent

non-profit organization incorporated for the sole purposes of the flight-training program. The organization is not subject to control by either Canada or Bombardier Inc. Milit-Air Inc. will purchase the planes, flight simulators and other equipment with the proceeds of a \$720 million bond offering. Bombardier Inc. has been appointed Milit-Air Inc.'s agent for the negotiation and purchase of the equipment. In addition, Milit-Air Inc. has granted Bombardier Inc. the right to use the facilities at the bases for flight training. By way of a separate agreement, Milit-Air Inc. has leased the equipment to Bombardier Inc. Under the Canada Services Agreement, Bombardier Inc. provides certain ground-based training and maintains the planes, equipment and base facilities; Canada pays tuition fees.

The tuition fees payable by Canada comprise several components: transition fees, firm fixed fees, firm fees (covering maintenance of aircraft and administration of premises), variable fees (covering life-sensitive spares, consumable spares and engine overhauls) and reimbursable costs (oxygen and petroleum). The firm fixed fees are payable semi-annually for 20 years, whether or not Canada trains the full number of pilots it is entitled to under the agreement. However, the agreement allows Canada to sell some of its unused pilot training to other countries. The firm fixed fees are sufficient to cover the semi-annual payments of principal and interest that Milit-Air Inc. is required to make to its bondholders. Bombardier Inc. has assigned its right to receive the tuition fees to a Collection Trustee. Once the Collection Trustee receives the tuition fees from Canada, the rental payments owed by Bombardier Inc. to Milit-Air Inc. for the planes and equipment are deemed to have been paid. The Trustee then pays to the Bondholders' Trustee the portion of the firm fixed fees equal to the principal and interest due on the bonds. The remainder of the firm fixed fees is held for the benefit of Milit-Air Inc. to cover its reasonable normal operating expenses. The other components of the tuition fees are paid to Bombardier Inc. for services rendered under the Canada Services Agreement.

If the Canada Services Agreement is terminated, Canada is obliged to assume

Bombardier Inc.'s rights and obligations under the lease agreement for the planes and equipment and to continue the rental payments for the equipment. These payments will, in turn, continue to provide the means for Milit-Air Inc. to meet its obligations to the bondholders.

Most of the training will take place at Canadian Forces Base Moose Jaw, Saskatchewan and some will occur at the base in Cold Lake, Alberta. According to the Department, the role of the Canadian military will consist mostly of conducting the flying training, overseeing the contractor support, managing the training content and standards, running the air traffic control and providing site services at Cold Lake. Bombardier Inc. will be responsible for the provision and support of aircraft and simulators, ground school training, classroom training systems and site maintenance services at Moose Jaw. This commercial option is similar to a number of others under the ASD program, which was developed to move various internally provided support services to the private sector when it makes business sense to do so.

About \$1.3 billion of the contract funds will be used to acquire flight simulators and a new fleet of 42 military training aircraft to replace National Defence's existing fleet of Tutor aircraft that, according to departmental studies, could have been refurbished and made to last until the year 2015. The remaining \$1.5 billion will be used by the Bombardier-led industry team to maintain the aircraft and the simulators, manage the base in Moose Jaw, and provide ground school instructors. National Defence will provide the overall management of the NFTC program as well as the flight instructors. The first flight instructors were to start training in the third quarter of 1999.

We reviewed the NFTC contracting process, using the following criteria:

- the contract awarding process should meet the requirements of the government contracting policies and regulations for integrity, openness and fairness;
- the pricing methods should provide best value; and
- the financing and contracting arrangements should be appropriate.

The contract was awarded without competition

We reviewed the rationale for awarding the contract without competition and the events leading to the contract award, to determine if National Defence and Public Works and Government Services Canada had complied with the government's contracting policy and regulations. We found that the decision to award the contract without following the normal bid solicitation process for government contracting was not adequately justified.

Our review of NFTC contract files indicated that the sole-source decision was based on the following factors:

- The Bombardier Inc.-led team included all of the companies that had bid as prime contractors on a 1991 contract to supply pilot training services at Portage-la-Prairie. Bombardier Inc. was awarded that contract because it was the lowest bidder.
- The proposed industry team was the only one that indicated a "committed interest" in the NFTC program.
- The deadline imposed by NATO for submission of a proposal precluded a competitive tendering.
- The availability of a competing pilot training program in the United States, and concern among NATO nations about the costs of contracted-out pilot training compared with their domestic costs, created incentives for Bombardier Inc. to keep training costs down.

Those reasons for awarding the contract without soliciting competitive bids do not meet the conditions specified in the Government Contracts Regulations. In the fall of 1994, Bombardier Inc. proposed the idea of a National Defence/industry collaboration to establish a NATO flying training program. This led to the submission of an unsolicited proposal containing a business case in December 1994. The NATO deadline for the submission of offers to host flying training was 1 February 1995, which was later revised to 1 May 1995. The deadline for submitting a fully costed proposal was June 1996. While it is probably true that the time between the receipt of the unsolicited proposal and NATO's deadline was insufficient for the government to

tender the project, "making a deal" does not match the definition of urgency in contract regulations.

During the course of our audit, officials told us that the benefits to be gained by the deal meant that competitive tendering was not in the "public interest". This does not conform to the criteria that define "public interest" in contracting policy.

Officials also told us that because they were satisfied that all Canadian companies qualified to bid were already part of the Bombardier-led consortium, a non-competitive contract was equitable. In addition, they pointed out that the government's intention to pursue NATO participation through a sole-source contract was highly publicized and that no other company came forward. A document we examined did indicate that another firm had expressed some interest.

We remain concerned about the equity of these practices. It cannot be stated with certainty that no other competitor would have come forward, possibly as part of a consortium including a foreign firm. In addition, publicity may discourage competition by making it appear that the government has made its decision.

Finally, officials argue that because Cabinet directed that a sole-source contract be let, no compliance problem exists. However, a directed sole-source contract of this nature must comply with the regulations. If it does not fall within the permitted exceptions, an order-in-council is needed to authorize the transaction. No such order-in-council was sought or obtained.

In public statements, National Defence has stated that "partnering" is a good strategy for a contract of this nature, involving a large, complex project. However, the Government Contracts Regulations make no provision for partnering, and the terms of this contract do not indicate that it is a partnership in a legal sense. Moreover, the term "partnering" is an elusive term now being used as a catch-all to describe almost any activity involving government and non-government organizations. We found that there are no clear policies or guidelines on how such arrangements should be set up and managed.

The profit markup in the NFTC contract is not consistent with current guidelines or supported by adequate analysis of contractor's risks

In the event of a sole-source contract, Public Works and Government Services Canada's profit policy and guidelines are supposed to establish the level of profit awarded to a contractor. The NFTC contract includes a profit markup of about \$200 million over 20 years. This markup was arrived at through direct negotiations between Public Works and Government Services Canada and Bombardier Inc. Public Works and Government Services Canada officials told us that the profit policy and guidelines are not designed for a project of this magnitude, complexity and period of performance, nor for a complex financing arrangement of this nature. They also stated that the profit markup that was negotiated with Bombardier was justified by the "material" and "substantial" risks assumed by the contractor. However, they could not provide us with the detailed calculations and risk assessments they used to arrive at the profit markup included in the contract. According to officials of both departments, the NFTC program will provide the government with valuable benefits through the transfer of significant risks to the contractor over the next 20 years. Although departmental documents show the departments' estimate of contractor risk to be between \$360 million and \$460 million, they had no calculations to support this. They estimate that the risk exposure to the contractor relates to the following:

- the quantity and adequacy of the aircraft required for the program;
- future increases in aircraft and infrastructure operating costs;
- failure to obtain the expected number of foreign participants; and
- environmental risks.

We expected that the two departments would comprehensively assess the risks being transferred to the contractor and estimate the value to the Crown of that risk transfer. We were unable to establish that this had been done.

Public Works and Government Services

Canada informed us that it hired an outside consultant to review the risk elements in this program. We note that the external consultant could not perform a comprehensive review of all the risks involved in the NFTC program since, at the time of his review, the agreements had not been finalized. Therefore, in our opinion the review was not sufficient to provide assurance that there is an equitable sharing of risks under the contract. Public Works and Government Services officials indicated to us that the risks of poor performance by the contractor were sufficiently moderated and managed by the provisions contained in the Canada Services Agreement. Nevertheless, the payment by Canada of \$1.3 billion in firm fixed fees is unconditional and irrevocable under the terms of this agreement, even if the contractor fails to perform. However, if Bombardier is replaced there is a provision in the contract that guarantees access to and use of the equipment for the period of the contract.

In response to our audit, National Defence officials prepared a risk summary in late September 1999 that attempted to quantify the value of the risks transferred to the contractor. While this summary clearly identified the major risks, it did not assess their probability of occurrence and their overall financial impact. As a result, it is not possible to establish the correlation between the value of the risks and the profit markup that was negotiated in the NFTC contract.

According to information provided to us by National Defence officials, Bombardier Inc. faced the risk of not recovering \$103 million of its costs if Canada were to be the only participant in the program. Based on current commitments by foreign countries, this amount has now been reduced to between \$15 million and \$30 million. Moreover, Bombardier maintains that it will earn its forecast profits only if the full, expanded program is achieved.

It would therefore appear that the risk associated with insufficient foreign participation has now been mitigated. However, the other risks mentioned above remain.

It should be noted that if the NFTC program expands beyond its current level and National Defence agrees to such an expansion, the Department is committed to paying for the additional aircraft and equipment that will be required. These costs would be recovered from the additional revenues from foreign participants. According to National Defence officials, if the program were to expand beyond its current capacity there would be significant financial benefits to both the Crown and the contractor, because the fixed costs of the program would be shared among a greater number of participants.

The chosen financing arrangements increase some risks

The NFTC program is the first example of "innovative" financing for a major National Defence capital project. This financing arrangement requires the contractor to supply most of the equipment and capital needed to provide support services. However, the Department is irrevocably committed to making the required payments to acquire the aircraft, simulators and other related assets.

The Department of Finance had suggested in late May 1997 that the Department consider purchasing the equipment directly and supplying it to the contractor as government-supplied equipment. In response, National Defence prepared an analysis of industry financing compared with government financing of the NFTC assets. We found that this analysis was not complete and that it was performed at a point when it was impractical to make any changes to the financing arrangements, since there would not have been enough lead time to purchase the

equipment and have it in place by the end of 1999.

The financing structure also posed additional risks to the government. Officials took steps to reduce the risks by including certain safeguards in the agreements with Bombardier Inc. and Milit-Air Inc. but not all risks could be circumvented. The main risk identified by Public Works and Government Services Canada is that if Milit-Air Inc. were ever to become insolvent, National Defence would face the drastic consequence of losing its access to the planes while continuing to pay the firm fixed fees. Therefore, should Milit-Air Inc. incur an expense of a type that the Department was not obligated to reimburse, National Defence would nevertheless, as a practical measure, be forced to inject the necessary funds into Milit-Air Inc. to keep it solvent. Public Works and Government Services Canada has assessed the likelihood of the occurrence of such expenses as very small. It notes, however, that their impact could be high. Officials told us that they have taken action to mitigate this risk.

The unique financing arrangements are also causing problems with the acquisition of the Raytheon T6-A aircraft and related technical data. The U.S. Department of State has serious concerns about a private company, Milit-Air Inc., owning military aircraft. It is concerned about Canada's ability to control the transfer of information and the use and resale of aircraft owned by Milit-Air Inc. The two governments have been working on a solution, and it is expected that the Canadian government will be providing the necessary assurances shortly. However, the issue is not yet completely resolved.

The fact that these additional risks are present leads us to believe that a more rigorous assessment of alternatives for acquiring the assets ought to have been prepared, and earlier in the process.

(continued from page 27–14)

Of nine projects that have gone to contract, three may not have selected the best option.

five of the projects we reviewed, including the NATO Flying Training in Canada program, did not meet our audit criteria in various respects.

27.50 The NATO Flying Training in Canada program assessed three options:

- extend the life of a portion of the Tutor fleet, close a base and use additional CF-18 flying to complete jet pilot specialty training;
- retire the Tutor fleet and purchase jet training offshore; and
- buy services from a contractor.

We found that the risk analyses associated with each option lacked quantification in numerous areas.

27.51 For the Goose Bay Support Services project, the study provided to us in lieu of a business case analysis did not analyze the contracting-out option in detail. Further, this study did not adequately define and cost the services to be provided. Nor could we find any evidence that a risk assessment had been undertaken.

27.52 We could not find a formal business case analysis or any other supporting evidence to justify the ASD contract at Meaford Area Training Centre. The limited documentation provided to us did not indicate that any other options were considered. The business case for the Aerospace Engineering Test Establishment project did not meet our audit criteria.

27.53 In the Automated Test Equipment project, the Department analyzed two internal options and one external option for providing services and purchasing equipment and spares. In the external option, the cost of the assets was based on the contractor's proposal to sell equipment and lifetime spares as a package. In the internal options, it was assumed that the Department would purchase the equipment and spares separately, which

would cost more. Our analysis indicates that if the same assumptions had been used for all three options, one of the internal options could have cost at least \$60 million less over 20 years than the estimated \$400 million cost of the external option chosen. However, the external option's ability to deal with short-term obsolescence was a qualitative factor that strongly influenced the decision.

The options chosen were not necessarily the best

27.54 Our audit criteria specified that the best option would be determined by ranking all options on the basis of qualitative issues and risks combined with the results of the cost analysis. Further, the best option would respond best to the issue or business requirement that had been defined early in the business case analysis.

27.55 In 9 of the 14 projects we audited, services have been contracted to industry, to an in-house team or to another government department. We are concerned that in 3 of the 9, including the NATO Flying Training in Canada project, the option chosen was not always supported by sufficient analysis.

27.56 In the case of the NATO Flying Training in Canada project, we have concerns about the cost effectiveness of the chosen option. We found that not all of the suggested options were adequately considered. For instance, the Department of Finance had indicated that it would be more economical for National Defence to buy the training aircraft itself instead of having the contractor purchase them. We found that although an analysis of financing the purchase of the training aircraft was performed, it was completed too late in the process, after a sole-source procurement strategy had been adopted. Also, the risk analysis was not quantified in several areas and lacked sufficient data to support the risk rating scale used to rank the options.

27.57 The Goose Bay Support Services and Meaford Area Training Centre projects lacked a business case analysis that included an analysis of options.

The Department has put improvements in place

27.58 As already noted, in 1997 the Department became concerned about the slow progress of its ASD projects. At the same time, it recognized that improvements were needed in the management of its ASD projects. It therefore took the following measures:

- An ASD Steering Committee at the assistant deputy minister level was created to oversee projects and to increase the sense of corporate urgency. The minutes of this committee indicate that new projects are subjected to a higher level of challenge and review than the projects we audited.
- The Department concentrated its efforts on four large projects: the Supply Chain, the Site Support Services project, Military Pay and Research and Development Branch.
- It made several improvements in the way business cases are developed. In the Supply Chain project, for instance, levels of service were more fully defined than in most of the projects we audited; baseline costs were established and then audited by an outside firm engaged by internal audit; and a recognized risk assessment technique was used to analyze the project.

27.59 We did not audit any of these new projects, except Military Pay, as they had not advanced far enough during the period covered by our examination. The generally favourable results of the Military Pay project indicate that management's efforts may be effective in addressing the deficiencies of earlier projects. We remain concerned that process improvements may not yet be resulting in substantive change. We intend

to review the newer projects when we undertake our follow-up to this audit.

General assessment of the business case analyses

27.60 Some elements of the business case analyses that we audited were well done: the aim was clear in most cases and success factors were defined. However, this does not compensate for failure to identify service levels, establish baseline costs or adequately assess options. The Department has already taken steps that, if followed through, should address the major deficiencies we found.

27.61 As it continues to devote a high level of senior management attention to Alternative Service Delivery projects, the Department should ensure that business case analyses:

- identify levels of service and baseline costs; and
- include adequate analysis of options.

Department's response: The Department will apply the same rigour to business case analyses for future ASD projects as it has for recent initiatives such as the Supply Chain. As new lessons are learned from the current initiatives under way, changes will be made to the ASD framework where needed.

The Department has already acted to improve its business case analysis and overall management of ASD projects. It is too early to assess whether results have also improved.

Human Resource Management

27.62 A complete management framework is required to support an Alternative Service Delivery program. Human resource planning for ASD is an important part of this framework. Our audit examined key components of good human resource management, including training, a core/non-core assessment of military personnel, a human resources plan, a compensation plan, and a staff relations plan.

27.63 We expected to find a department-wide classification of core/non-core activities, core and

National Defence still needs to provide additional guidance on determining core and non-core personnel and activities in the remaining ASD projects.

non-core personnel, and a strategy developed with the help of human resource specialists to ease the transition into ASD. We also expected work force adjustment costs to be considered in the ASD cost analyses. Finally, we expected to find communication with unions throughout the ASD process and a plan to treat employees fairly during the ASD transition, including provision of employment opportunities, continuity of employment and compensation supplements.

Gaps in training are evident

27.64 To successfully implement the ASD program there has to be a clear, easily understood methodology, and staff with the necessary skills to apply it. One major challenge facing National Defence is to ensure that staff who conduct ASD reviews have the skills to collect, assemble and analyze the information required for the business case analyses and to prepare in-house bids. The Department has developed an ASD methodology and costing guidelines; however, our audit found that training was deficient.

27.65 We found that although many of the staff were very dedicated and hard-working, in many cases they had not been trained to prepare the business cases, the detailed statements of work and the analyses needed to make ASD decisions. This lack of training was cited as a cause for concern in the 1998 Quality of Life Report prepared by the Standing Committee on National Defence and Veterans Affairs. The report noted that employees who had participated in the ASD process expressed concern that they had to prepare their ASD in-house bid submissions on their own time — after hours and on weekends — and that they entered the process as complete amateurs. In our review of business case analyses, we found wide differences in quality. The Department has recently developed ASD practitioner workshops and conducted a

number of courses in the application of ASD methodology.

Core/non-core assessments have not been timely

27.66 A core/non-core assessment includes two main components that are required for proper business case analysis: the determination of core personnel and the determination of core activities. These should be the first steps of the ASD process. Failure to complete these steps will delay ASD projects and forgo potential savings.

27.67 In 1997 the Department conducted a Combatant Capability Study that was related to determining core activities. The results of this study were presented to the Defence Management Committee in October 1997 and were among the key inputs to the Department's major corporate ASD initiatives. We found that the Department is conducting Military Occupational Structure reviews, which relate to core personnel, on a periodic basis. During our audit, we noted that some projects have had to wait for up-to-date information on occupational structures.

Human resource plans need to be finalized

27.68 If a non-core activity becomes the subject of ASD, change ensues and the jobs of individuals are affected. A human resource plan needs to be developed with the help of human resource specialists to ensure that affected employees will be treated fairly. Failure to consider human resource factors in the planning of ASD could disrupt the successful implementation of ASD projects.

27.69 Our audit findings at Goose Bay are an example of the problems that can arise when human resource factors are not properly considered. In addition to buyouts and voluntary departures, the Goose Bay initiative involved wage cuts for many employees, loss of allowances

and subsidized housing, transfer of employees to the contractor and offers of blue-collar jobs to white-collar workers. The Department underestimated the human resource impact of these changes. This resulted in extreme dissatisfaction, requiring the Minister to intervene to resolve matters. The lessons learned from the Goose Bay project have resulted in changes to the ASD policy. For example, since May 1998 a new directive has required that any new ASD initiatives that lend themselves to in-house competitive bids will first be tested for savings through a “most efficient organization” to determine if they should proceed to competition with the private sector. This step involves reviewing the in-house activity and taking the necessary steps to ensure that it is conducted in an efficient and cost-effective way. Departmental officials informed us that human resource strategies have now been developed and are awaiting final approval.

Compensation management problems appear to have been resolved

27.70 Government compensation policies, labour code provisions and work force adjustment costs must be considered when determining the costs of proposed ASD initiatives. The Work Force Adjustment Directive is a federal government policy that attempts to maximize job opportunities for public servants and ensure continuity of employment. It provides for compensation to employees who are adversely affected by ASD. The labour code includes a provision for successor rights that, under certain conditions, requires successor employers to honour existing collective agreements until they expire. This means that a contractor may be required to continue paying employees their present salaries even if they are higher than the prevailing market wage. Failure to properly include work force adjustment costs and to consider successor rights in an ASD analysis could mean that ASD initiatives are pursued that are not

cost-effective. The proper inclusion of these costs may change the relative ranking of the options being considered.

27.71 Any ASD project considering the contracting-out option is affected by government compensation policies, under which the Treasury Board currently pays salary benefits (pensions, employment insurance, etc.) equivalent to approximately 20 percent of each employee's salary. Under a contracting-out scenario, National Defence would be responsible for paying these benefits. This means that any ASD option considered by the Department must save at least 20 percent of the salary costs of departmental staff if the Department's budget is to receive any direct benefit from the change. A contracting-out option could offer the service at a lower overall cost to the government and still be rejected as not cost-effective for the Department. In some ASD projects we examined, it was not clear that salary benefits and costs of work force adjustment had been properly taken into account in calculating ASD costs. If they were not, the savings from these projects will be lower than expected. The Treasury Board recently indicated that it will now pay National Defence 20 percent of salary savings on future ASD projects, provided that the Department has met its targeted military and civilian personnel reductions.

27.72 The Goose Bay ASD initiative is an example of a project that did not properly consider the labour code provisions for successor rights. The Department did not obtain a timely legal opinion on the possible application of successor rights. Potential bidders were advised, during the PWGSC-sponsored bidders' conference at a Goose Bay site visit in May 1997, that federal successor rights would not apply. In June 1997, specific questions dealing with the issue of successor rights were raised by one of the bidders. Public Works and Government Services Canada subsequently provided responses to these

Failure to co-ordinate government compensation policy created an impediment to contracting out.

This now appears to have been resolved.

questions that were distributed to all potential bidders. The bidders were advised, “The final determination on the applicability of successor rights under provincial and federal legislation can only be made by the labour board of the jurisdiction to which the function is transferred. The parties to that determination are the new employer, the unions and the board. Therefore, as bidders you are strongly urged to pursue, as expeditiously as possible, the applicability of successor rights with those parties.” The Department agreed to pay the costs that would result from a subsequent decision if successor rights were found to apply. Costs associated with the potential application of successor rights were excluded from the bids. In November 1998, the Canadian Labour Relations Board issued a decision certifying that successor rights would apply at Goose Bay. The total cost that the government will have to pay as a result of the application of successor rights has yet to be finalized. Government officials told us that the cost of applying successor rights could be over \$30 million for the five-year period of the contract. The Goose Bay experience illustrates that the potential application of successor rights is an important risk factor to be considered in the planning phase of any ASD project. The application of successor rights can considerably reduce the forecast savings.

Employees were adequately consulted

27.73 Staff relations are also a very important aspect of ASD initiatives. According to the Treasury Board Secretariat, one of the key human resource factors in the success of an ASD initiative is “free-flowing communications with employees and their representatives to reduce uncertainty and ease the transition process.” If the staff relations framework is not appropriate — for example, if it fails to adequately involve the unions in the process — then ASD initiatives are less likely to succeed.

27.74 Our findings show that the unions were participants in all of the Department’s ASD projects. The minutes and letters show that they participated in meetings, but they question their level of influence on ASD decisions.

General assessment of ASD human resource management

27.75 The most serious gap we identified in the human resource aspect of the ASD program was in staff training. Adequate business case analyses are unlikely to improve until staff are trained. We also noted that progress has been made in developing human resource strategies. Additional guidance on core/non-core assessment still needs to be provided for the remaining ASD projects. At the same time, the most significant disincentive to contracting out — the issue between Treasury Board Secretariat and the Department over the payment of benefits — appears to have been resolved. We also found that there have been consultations with employees.

27.76 **The Department should ensure that its Military Occupational Structure (MOS) reviews provide the guidance on core/non-core assessment required for Alternative Service Delivery projects.**

Department's response: As the military situation changes, the Department will continue to conduct periodic MOS reviews to ensure that occupational structures meet military missions as directed by the government. Pertinent information resulting from these reviews will be made available to ASD projects.

27.77 **The Department should ensure that people are trained to evaluate and implement Alternative Service Delivery projects and that appropriate human resource management plans are in place.**

Department's response: With recent ASD initiatives, the Department has taken steps to ensure that the staff involved in the development of the business case analyses

were properly trained and, where gaps could not be filled in-house, that adequate expertise from outside the Department was brought in to supplement this deficiency. The Department will pursue this approach with any future ASD initiatives.

In the same vein, the Department has introduced corporate human resource strategies for employment continuity in all ASD situations both for military and civilians; consultative mechanisms with all unions both at the corporate and project levels; early involvement of human resource management specialists in ASD project teams; more frequent and direct communication with all employees; and awareness and training workshops on an as-required basis. The Department will continue to monitor results and incorporate appropriate adjustments.

Contracting

The competitive process was not always followed in the awarding of contracts

27.78 The government procurement process is based on the principles of probity, openness, transparency and the ability to withstand public scrutiny, equal access, competition and fairness. According to National Defence, the ASD program is based on a philosophy of fair and open competition. We expected to find that the normal bid solicitation process for government procurement would be used when opening non-core support services to competition under the ASD program. The Government Contracts Regulations permit sole-source contracts under certain conditions — namely, when the need is one of pressing emergency in which delay would be injurious to the public interest, the nature of the work is such that it would not be in the public interest to solicit bids, only one person or firm is capable of performing the contract, or the estimated expenditure does not exceed \$25,000.

27.79 Our audit of ASD contracts raised a number of concerns about value for money and the equity and fairness of the contracting process. The existence of sole-source contracts reduces the potential for ensuring that the Department is obtaining the required services at the most economical price. Five of the nine ASD contracts we audited, including the \$2.8 billion NATO Flying Training in Canada contract, were awarded without competition. We have concerns about two contracts, one that was awarded without competition and one that is about to be extended for a three-year period.

27.80 **NATO Flying Training in Canada.** We reviewed the rationale for awarding the contract without competition and the events leading to the contract award, to determine if National Defence and Public Works and Government Services Canada had complied with the government's contracting policy and regulations. We found that the decision to award the contract without following the government's normal bid solicitation process was not adequately justified. The case study on page 27-15 provides additional details.

Both the government contracting process and the ASD program are based on the principles of fair and open competition. We found that some projects did not follow these principles.

27.81 **Canadian Aviation Training Centre (CATC) — (Portage-la-Prairie).** This contract with Bombardier Inc., which deals with primary flying training, basic helicopter training and multi-engine training, expired in August 1999 and is currently being renegotiated for a three-year renewal, without competition. While this contract amendment worth about \$100 million does not contravene government contracting policy, we are still concerned about the principle of competition. Departmental officials told us that in order to have a new contract in place by 1999, it would have had to issue a request for proposal in 1996. At that time, the decision to proceed with the NFTC project had not yet been made and National Defence was not in a position to

The army's Meaford Area Training Centre is being operated by a contractor with a five-year, fixed-price contract of \$40 million. Only 43 percent of the Centre's capacity was used in 1998.

The government lacks an appropriate contracting framework for complex alternative service delivery arrangements. Until one is in place, compliance will be undermined and the benefits of competition forgone.

define its future flying training requirements.

Public Works and Government Services Canada profit policy and guidelines were not followed

27.82 Public Works and Government Services Canada has developed a profit policy and guidelines for determining fair and reasonable profit allowable under a sole-source contract. These guidelines indicate that the profit levels will vary to recognize the levels of general business and contractual risk assumed by the contractor and the cost of money associated with capital used by the contractor in performance of the contract. In the case of the NATO Flying Training in Canada program, the profit policy and guidelines were not followed and the analysis to justify the profit markup was inadequate (see case study on page 27–15).

The Department has purchased unused training capacity

27.83 National Defence has difficulty forecasting the level of training required and, as a result, it is paying for services and capacity it is not using. Our audit found examples of this in two of the ASD projects we examined.

27.84 Meaford Area Training Centre. The Meaford Area Training Centre is a modernized army training facility located in central Ontario that was opened in July 1995. Initially tasked to provide and maintain firing ranges, training areas, facilities and equipment for approximately 10,000 Reserve soldiers in the Ontario area, it has a total training capacity of 384,000 student-days per year. The contractor estimates that the actual utilization rate for Meaford in 1998 was approximately 43 percent of total capacity. The facility includes 44 separate buildings and structures, some 400 military and commercial style vehicles and various items of support

equipment, water and sewage facilities, refuelling and maintenance facilities, several kilometres of roads and an extensive training area. It is currently operated by a private contractor under a five-year, fixed-price contract valued at \$40 million.

27.85 Canadian Aviation Training Centre, Portage-la-Prairie. The \$165 million contract signed in 1991 with Bombardier Inc. to operate the Canadian Aviation Training Centre at Portage-la-Prairie is another, largely fixed-price, contract to operate a facility that National Defence has consistently underutilized. This is primarily due to the difficulty of forecasting future pilot training needs. The Department estimates that in the first six years of the contract, payments for unused capacity of about 20 percent amounted to a maximum of approximately \$11 million.

General assessment of adherence to government contracting policy

27.86 The government's contracting policy framework does not provide adequate guidance to departments for entering into complex alternative service delivery arrangements such as the NATO Flying Training in Canada contract. This gap needs to be filled, particularly if the government plans to retain the principles of fairness and competition when awarding large long-term contracts that involve partnering between government and industry and require complex financial arrangements.

27.87 The government's contracting policies and regulations were not followed in several of the ASD projects we examined. In particular, the NATO Flying Training in Canada contract was awarded without competition and the profit markup is not consistent with Public Works and Government Services Canada's profit policy and guidelines. The pricing of some contracts did not result in value for money, because National Defence did not need all of the services it was paying for

and there was no provision for reducing the fixed payments established under the contracts.

27.88 The Treasury Board Secretariat should include, in its continuing work on procurement reform, guidelines and training for large multi-year service contracts. The guidelines and training should address the key issues of how competition is to be addressed in situations where long-term “partnering” would be beneficial to the government.

Treasury Board Secretariat’s response:
This audit focussed on the resource management principles of ASD and how these specifically apply to contracting-out initiatives. ASD also includes other types of initiatives, including restructuring within the federal public service and partnering with others. In addition to cost effectiveness, ASD is generally expected to improve services to clients, increase management flexibility and reduce risk.

This report contains several useful practices to consider in future ASD initiatives. These will be reflected in the ASD Practice Guide and Database that is currently being developed by TBS. This tool will pull together the collective experience on ASD to guide the evolution of ASD throughout the federal public service.

With regard to the recommendation in paragraph 27.88, the Treasury Board Secretariat is currently taking the lead on an interdepartmental initiative to reform procurement. We aim to modernize procurement, addressing policy considerations that govern the full procurement lifecycle. The objective of the initiative is to help departments better serve the public through cost-effective procurement strategies while still maintaining appropriate opportunities for Canadian suppliers to compete and to uphold the integrity of the federal procurement system. This initiative should include, among other matters, work on

guidance for large, multi-year service contracts. As well, as part of procurement reform, we are committed to developing a program of training and certification for procurement specialists in departments.

Public Works and Government Services Canada’s response: Public Works and Government Services Canada is supportive of continuing work on improving the guidelines and training for large multi-year service contracts and will be working with Treasury Board Secretariat in this regard.

Conclusion

27.89 Overall, the ASD program has resulted in some limited success for the Department. Although we could not verify that the savings claimed by the Department have been realized, some projects appear to have been successful. Since the Department has completed only 18 projects with annual budgets totalling \$202 million, if it can resolve implementation problems there is still a potential for significant additional savings from ASD projects currently under way. These cover activities with annual costs totalling over \$1.2 billion.

27.90 The Department currently has an adequate framework to manage alternative service delivery. This framework had not yet been put into practice for many of the projects we audited. We found that improvements have been made that appear likely to address problems in the future. At the strategic level, the savings projection for the program appears to have been set arbitrarily and may not have been realistic. At the project level, business case analyses varied widely in quality. Managers appear to lack the necessary tools and training.

27.91 Our results indicate that the federal government has much to do before realizing the full advantage of service contracting. The existing government contracting policy is based on competition and assumes that a marketplace exists

from which the federal government can solicit bids. This may not always be the case, especially for large contracts where there may be only a single Canadian firm available. It appears that the government needs to consider exactly what it means by “partnering”, under what circumstances it would be advantageous, and how competition should be used to keep costs in check. Until this is done, officials will be unable to exploit commercial possibilities and will also be in danger of contravening existing regulations.

27.92 Finally, it is apparent that there is a need for the Department to exercise better business judgment. Contracts may well offer theoretical savings, but these are easily negated by poor business deals. The case of Meaford is an outstanding example of contracting for services that were not required. Public Works and Government Services Canada also needs to ensure that the profit markup on negotiated contracts is supported by an adequate analysis of the risks transferred to contractors.

National Defence's comment: As a strategy to carry out the 1994 Defence White Paper operational requirements, the Department remains firmly committed to divesting itself from delivering non-core activities where it is cost-effective and practical.

The Department acknowledges that results in terms of cost efficiencies for the ASD program as a whole have been lower than those expected for the 1999 timeframe. However, despite the difficulties inherent

in the implementation of such innovative initiatives in Canada and in other countries, our own experience in DND since 1995 demonstrates clearly that our expectations in percentage of savings at the individual project level are realistic.

The objectives underlying the ASD program are of a long-term nature. Difficulties in the implementation of the 14 early ASD initiatives that are part of this audit are not an indication that these objectives must be modified. Rather, they indicate the need to have the appropriate framework in place to support our level of commitment. The Department has learned a lot from these difficulties and, as the audit has pointed out, it has incorporated these improvements into a more effective framework, particularly for business case analyses and training. We will continue to review the framework and make necessary adjustments where needed.

It is also worth noting that, despite this audit's focus on contracting out, the DND ASD program includes initiatives that made use of other ASD options such as departmental agencies.

As a final point, the Department believes that the NATO Flying Training in Canada program is innovative and provides good-quality pilot training at a cost lower than the current training system or any foreseeable training option in the future. In the Department's view, the fact that the program is on schedule, on budget and sold out is indicative of the viability of the concept.



About the Audit

Objectives

The objectives of this audit were to determine whether:

- National Defence is realizing savings and other expected benefits from alternative service delivery (ASD) initiatives;
- National Defence has an adequate management framework to support the implementation of the ASD program, particularly in the areas of human resource management, business case analysis, costing and contracting; and
- contracts awarded under the ASD program met the integrity, openness and fairness requirements of the government contracting policies and regulations and that they adequately reflected requirements, have followed appropriate pricing methods, had appropriate financing arrangements and were properly monitored.

Scope

We selected 14 projects covering non-core support services that the Department had reviewed to determine whether they should be retained in-house or contracted out. Our sample was selected on the basis of judgment and included projects from each of the three commands — navy, army and air force — and from various headquarters groups. Five projects were not formally part of the ASD program, but involved major contracting for service initiatives and were therefore included in the audit.

Our audit was limited to actions taken by the government. We did not audit the firms providing services or bidding on contracts and imply no criticism of any third party supplying services to the government.

We reviewed departmental project files and interviewed National Defence officials, including headquarters and regional staff responsible for conducting the ASD reviews and implementing ASD projects. We also interviewed Public Works and Government Services Canada contracting officials and staff at the Treasury Board Secretariat. In addition, we conducted a literature review to determine the lessons learned by other countries that have implemented similar initiatives.

Criteria

In assessing the ASD program, we used the audit criteria contained in the Office of the Auditor General's guide, *Auditing the Contracting Process in Government Departments and Agencies*, as well as National Defence's publication, *Guide to ASD Methodology*.

Audit Team

Assistant Auditor General: David Rattray

Principal: Peter Kasurak

Directors: Joseph Reperto and David Saunders

Linda Beaulieu

Chantal Michaud

Darlene Mulligan

Julie Erb

Michael Amadio

Chris MacDonald

Nadine Lamoureux

Haleem Mughal

Robert Stopford

Tristan Velez

For information, please contact Peter Kasurak.

Appendix

Descriptions of the Audited Alternative Service Delivery Projects

NATO Flying Training in Canada (NFTC) – Moose Jaw *

Based on initiatives from Bombardier Inc., Defence Systems Division, Canada and an industry team led by Bombardier have established a military fighter pilot training program for the Canadian Forces as well as the military air forces of other nations who choose to participate. The industry team, which includes Frontec Corporation of Edmonton, CAE Aviation Limited of Edmonton and CAE Electronics of Montreal, will provide fully serviced aircraft, training material, flight simulators, airfield and site support services and other services.

The contract was signed in May 1998 and is valued at \$2.8 billion. It covers over 20 years of flying training and will end in December 2021. Although this project was initiated before National Defence announced its formal ASD program, it does incorporate many ASD principles.

Canadian Aviation Training Centre (formerly CFB Portage-la-Prairie)*

As a result of the 1989 federal Budget, the Minister of National Defence directed that Canadian Forces Base Portage La Prairie be closed by July 1992. This resulted in the decision to contract out four elements of the Canadian Forces pilot training system — Primary Flying Training, Basic Helicopter Training, Multi-Engine Training and Continuation Flying Training. The site was sold to a non-profit development corporation for \$1, resulting in the creation of Southport Aerospace Centre Inc. (SACI). SACI's fundamental concern is the creation of employment.

The initial five-year contract was awarded in 1991 to an industry team led by Bombardier Inc., Canadair Defence Systems Division. Under the contract, Bombardier Inc. provides primary flying training using industry-provided aircraft; the multi-engine training aircraft are contractor-owned; the helicopters are owned by National Defence and loaned to the contractor. Bombardier Inc. also provides facilities such as classrooms and offices. Finally, under an agreement with SACI, Bombardier Inc. operates the airfield, provides air traffic control and attends to student housing and feeding.

The initial contract, which ended 31 August 1997, included an irrevocable option to extend the contract for two additional years. The option has been exercised and the contract now ends 31 August 1999. A decision has been made to further extend this contract for a three-year term ending in August 2002. The full value of the contract extended until 31 August 1999 is \$236 million. The three-year extension is estimated at \$100 million.

Munitions Experimental Test Centre (METC)

An ASD study conducted in 1996-97 examined the activities of the Proof and Experimental Test Establishment (PETE) at Nicolet and the Defence Research Establishment Valcartier (DREV) South at Val Bélair. The study identified sufficient similarities in technological capabilities and strategic direction to recommend that a combined entity would be a highly feasible option that should yield savings through the rationalization of staff, facilities and equipment.

The study also recommended that National Defence cease to provide contract compliance (quality assurance) testing of ammunition, which would be assumed by the manufacturer, SNC Industrial Technologies (SNC IT). This work will be performed by the manufacturer on the Nicolet site. As a result, starting on 1 April 1998, the current contract with SNC IT was increased by about \$3.9 million per year to include compliance testing.

The research activities have been combined at the Val Bélair site. The total annual budgeted amount for the revised combined entity referred to as the METC is estimated at \$9.5 million, which includes the \$3.9 million contract amount.

* These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

CF-18 Automated Test Equipment Avionics Support

Canadian Forces avionics technicians use software-driven Automatic Test Equipment (ATE) to test and repair both the black boxes and their circuit cards for CF-18s. This work as well as maintenance of the related software and equipment was identified for ASD. As a result of this ASD initiative, the Department started discussions with Harris Corporation in 1996 on the possibility of industry working with the Department to find ways to reduce ATE support costs for the CF-18 aircraft.

A group of companies led by Harris Corporation has been actively pursuing this potential business venture. During the period August to November 1996, this group briefed various members of the Department on its concept of CF-18 ATE operations and maintenance. The formal proposal submitted by the industry team recommended that a joint Consolidated ATE Facility (CATEF) be established in Calgary and operated by a contractor with an option of assigning military personnel to maintain currency in hands-on testing. This proposal also recognized the problem of obsolescence with the older static ATEs and recommended the purchase of portable ATE equipment (PAT). After evaluating the internal and the commercial options, National Defence decided to contract out with Harris Corporation to operate the CATEF and to purchase up to six PATS to deal with obsolescence.

A 10-year contract was signed 16 June 1999 and includes \$65 million for the purchase of equipment and \$85 million for the purchase of services and spare parts.

Ottawa Publications Depot (in-house bid)

The Ottawa Publications Depot was identified as a candidate for ASD in February 1996. It provides warehousing, printing and distribution services for DND's publications and audio-visual materials. Its customers include National Defence, other government departments and individuals. The in-house team competed against a private sector firm and won with its proposal to reduce costs by 34 percent. The depot will operate under a three-year Service Level Agreement (SLA) with a value of \$9.2 million.

Project Genesis*

Project Genesis was chartered on 7 February 1995. The project commissioned a small core team to begin re-engineering in the Air Force organizations. The project focusses on the Fighter Force. Its goal is to reduce enterprise costs of the Fighter Force by at least 25 percent of 1993–94 costs.

The total 1993–94 costs (in 1994–95 dollars) for the Fighter Force were \$1 billion for personnel, operations and maintenance, and \$264 million for capital. The Department estimates that it has achieved a cost reduction of \$310.6 million or 31.6 percent.

This is not an ASD project, although some of the smaller projects involved under Project Genesis are.

Meaford Area Training Centre*

The Meaford Area Training Centre is tasked to provide and maintain ranges, training areas, facilities and equipment for approximately 10,000 Reserve soldiers in the Ontario area. It has a total capacity of 384,000 student-days per year. The centre opened in July 1995.

All support services were contracted out from the day it opened. National Defence considered this to be an initial ASD pilot project that could serve as a model for implementing the ASD program. A \$40 million contract is in place for the period of October 1995 to November 2000.

Goose Bay Support Services

The Goose Bay base is primarily used for flight training by European Allied Forces. A 10-year agreement between National Defence and the participating ministries of defence was established in 1986 and renewed in 1996. It provided for approximately \$80 million in annual payments for the use of Goose Bay for flight training. In 1995, this represented approximately 68 percent of the base's total expenditures of \$118 million.

These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

The Goose Bay base was not directly supporting a Canadian Forces operational role, so its services were prime candidates for ASD. In 1995, the Vice Chief of the Defence Staff approved a recommendation that a request for proposal be issued to the private sector for Alternative Service Delivery at Goose Bay. In April 1997 a request for proposal was issued for the management and delivery of non-core services in support of the Allied low-level flying training program, civil aviation and other third-party users.

In April 1998, a five-year contract was awarded to Serco to provide base support services. The \$135 million contract covers the period from 1 April 1998 to 31 March 2003. Under this contract, the Department expects that the costs at CFB Goose Bay will be reduced from \$44 million to about \$22 million annually.

Trenton Food Services

Canadian Forces Base Trenton is Canada's largest air transport base. The base consists of a full-sized airport that handles all types of military and commercial aircraft. It also functions as a significant training facility, providing a diverse range of training and development programs for the military.

The food services requirements at the base include entitlement meals, flight meals, and food service supply procurement. The service had an annual cost of \$4.2 million. In 1994, an ASD project was initiated to determine if food services could be obtained at a lower cost by having a competition between the in-house team and private sector firms. The in-house team won the competition and has been the food provider at CFB Trenton since 1 April 1998.

Military Pay *

Military Pay Service (MPS) is controlled by three major stakeholders, none of which can be considered its single owner. MPS processes payments for the Regular and the Reserve forces, comprising approximately 60,000 and 30,000 members respectively. The pay system also ensures payment of deployed personnel, manages financial arrangements for the families of deployed staff, processes personnel information and accepts input from military staff at various bases. The purpose of the Military Pay project was to provide the same levels of service at a lower cost.

In 1994, the cost of delivering Regular Force military pay services was \$55 million. An internal study determined that \$15 million in costs could be avoided if the pay system became a “most efficient organization” (MEO). This saving has already been achieved through downsizing and re-engineering efforts that have reduced the cost of this activity to \$31 million, as reported in 1997. It is expected that this cost can be further reduced by the implementation of additional departmental initiatives in this area.

The ASD process has been deferred for the time being and the Department retains the current MPS arrangement. Several factors are responsible for the deferral of ASD. First, there is disagreement among the stakeholders about the funding for a contract. Second, the MPS study indicates that internal re-engineering should be completed before contracting out is considered. Third, it is questioned whether contracting out would actually save money.

Auxiliary Fleet Operations – Esquimalt and Halifax Fleets

The auxiliary fleets in Halifax and Esquimalt, otherwise known as the Queen's Harbour Master (QHM), are autonomous line units. The QHMs are responsible for operational support to the naval fleet, associated bases, fleet maintenance facilities (FMFs), defence research establishments and other government departments. They are also responsible for the management and operation of the Canadian fleet of auxiliary vessels.

Using the limited data available, the total program cost was estimated at \$15.4 million for the Halifax fleet and \$11.8 million for the Esquimalt fleet. The purpose of the Auxiliary Fleet Operations project was to determine which of the 91 activities in the fleet support program qualified as candidates for ASD. The program identified activities that could be contracted out. Efforts are continuing to implement some measures that will increase cost effectiveness.

* These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

National Defence Headquarters (NDHQ) Facilities Management

NDHQ Facilities Management (FM) is a service that costs approximately \$1.4 million and includes such responsibilities as space management, space layout and design, parking administration and conference room management. The FM project was to determine if the service could be contracted out at less cost than it could be provided internally.

A Facilities Management Agreement was signed in 1997 requiring Public Works and Government Services Canada (PWGSC) to deliver the FM service for two years, starting 4 September 1997. National Defence estimates savings of \$403,000 in the first year and \$281,000 in the second. In April 1998, the agreement was expanded and construction engineering services were transferred to PWGSC.

Aerospace Engineering Test Establishment (AETE)

AETE is located at CFB Cold Lake in Medley, Alberta. It provides flight test service to the Canadian Forces (CF) as well as flight and technical evaluations of aircraft and aerospace equipment. Moreover, AETE maintains expertise in flight test and aircraft maintenance for a widely varied fleet that includes some unique equipment. Further, a large engineering and technical staff is required to plan and conduct tests, collect and analyze data, and provide conclusions and recommendations following each aircraft and system evaluation.

AETE was identified as a candidate for ASD in July 1995. The ASD process was initiated to market the excess capacity of the facilities to the private sector and foreign militaries, to capture technological advantages of private sector firms and obtain private sector funding. In March 1998 a decision was made to retain current arrangements.

Fleet Maintenance Facilities

The Fleet Maintenance Facilities at Halifax (Cape Scott) and Victoria (Cape Breton) provide engineering and maintenance services to Canada's Navy. The full cost of operating the production divisions of these facilities during 1996 were estimated at \$75 million and \$54 million respectively.

The May 1996 ASD analysis report concluded that delivering ship repair and maintenance services by alternative means would not result in improved cost effectiveness at that time. The report recommended that the production divisions of these facilities continue to seek the most effective mixture of public and private provision of repair work in a manner that would support the needs of both National Defence and the shipbuilding industry. The initial target date set for achievement of a "most efficient organization" (MEO) is December 1999.

* These projects were initiated prior to the promulgation of the ASD policy and the release of the ASD methodology.

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to the House of Commons

Chapter 28
Canadian International Development Agency –
Financial Controls Over Projects

November 1999

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Chapter 28
Canadian International Development Agency –
Financial Controls Over Projects



November 1999

This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 28

Canadian International
Development Agency

Financial Controls Over Projects

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Canadian International Development Agency

Financial Controls Over Projects

Main Points

28.1 CIDA's financial controls are effective in monitoring and controlling the flow of funds for projects, and in tracking the financial status of projects — that is, what has been spent and what remains to be spent. However, reports on the progress of projects often do not compare what has been accomplished with what was planned. This makes it difficult to determine the rate of progress or to analyze the financial implications of changes from expected progress. The result is a risk that project scope may have to be reduced or the budget increased to accomplish the intended objectives.

28.2 CIDA uses audits as a means of ensuring that its executing agents are respecting the financial conditions in its contracts with them. These audits have generally indicated that expenditures by executing agents are largely in accordance with contract conditions. In the contracts we audited, the amounts identified as possible adjustments because of non-compliance with contract conditions were relatively small — \$32.2 million out of about \$932 million. However, CIDA's audits have also identified some persistent problems of non-compliance with contract conditions. CIDA has released (that is, waived) some dollar adjustments identified as amounts to be repaid by the executing agents as a result of non-compliance. The rationale for doing so was documented in most cases but, in our view, the reasons given did not always justify the releases. From our sample, we estimated these amounts to be \$12 million to \$13 million over the four years of reports we examined.

28.3 We believe that the Performance Review Branch needs to be more active in auditing whether the system of financial controls is functioning as intended.

Background and other observations

28.4 CIDA is responsible for managing about \$1.8 billion of Canada's international assistance. Just over \$1 billion represents contributions to third parties, usually referred to as Canadian executing agents (CEAs), to deliver development assistance projects. Executing agents may be Canadian or developing country institutions, provincial governments and their organizations and agencies, or Canadian private sector firms.

28.5 CIDA has put in place a number of financial controls to support the management of its aid projects. At the centre of project management is the contract or the contribution agreement with the CEA. CIDA uses audits to ensure that CEAs are complying with its contracts and contribution agreements. In this audit, we wanted to see if CIDA's financial controls for projects were functioning as intended. We also wanted to examine the actions taken by CIDA to deal with the results of its compliance audits of these projects.

28.6 Although we noted problems of non-compliance with contracts, in nearly all the contracts we examined we also observed that once there was agreement between CIDA and a CEA that money should be repaid, CIDA recovered the amounts owing. Information generated by the audits commissioned by CIDA was being assembled and analyzed, but was not presented to senior program management for action.

The Agency has accepted our recommendations and agreed to take action to address the issues raised.

Introduction

28.7 Canada's International Assistance Envelope for 1999–2000 totals just over \$2 billion. CIDA is responsible for managing about \$1.8 billion within this envelope.

28.8 Nearly all (\$1.7 billion or about 93 percent) of CIDA's budget for 1999–2000 is allocated to development assistance programs (see Exhibit 28.1). Operating and capital expenditures of \$131 million (about 7 percent) make up the rest of its budget. CIDA's \$1.7 billion in program expenditures are made in the form of grants, contributions and other transfer payments. These payments are made to Canadian and developing country institutions, provincial governments and their organizations and agencies and Canadian private sector firms, for specific development projects, programs and activities.

28.9 Just over \$1 billion represents contributions to third parties, usually referred to as Canadian executing agents (CEAs), to deliver development assistance projects. Payments are made to the CEAs according to conditions stipulated in their contracts or contribution agreements. Information on the breakdown of amounts between the types of payments is not available. However, a rough rule-of-thumb

is that contracts are used for payments to private sector firms, and contribution agreements for other governments and not-for-profit organizations. For purposes of this audit, we treated payments under both arrangements as the same.

28.10 In December 1998, we reported on CIDA's implementation of its results-based management approach, with an emphasis on how it plans, manages for, measures and reports project results. In the current audit, we examined the financial controls CIDA has put in place to support the management of its aid projects. Our next audit will examine the management of contracting for goods and services, including the selection of Canadian executing agents to manage projects.

28.11 Two other audits related to financial management in CIDA are also under way. CIDA is one of the four departments included in Chapter 30 of this Report on sole-source contracting; that chapter reports on compliance with the contracting rules in a sample of professional service contracts. A second audit, to be reported in October 2000 as part of a government-wide audit, will include CIDA in an examination of how well departments are meeting our expectations for effective financial management as set out in the Financial Management Capability Model we published in April 1999.

**Just over \$1 billion of
CIDA's annual budget
is paid to third parties
to deliver aid projects.**

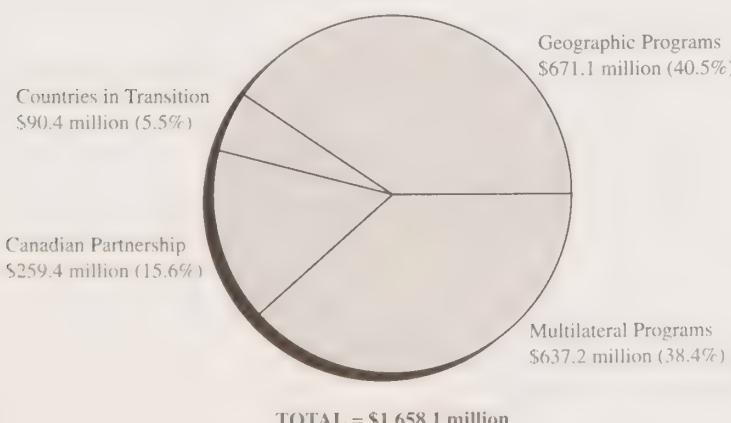


Exhibit 28.1

CIDA's Program Budget
for 1999–2000

Source: CIDA

Focus of the audit

28.12 CIDA has put in place a number of financial controls for planning and managing its development projects. Our purpose was to examine whether these controls are functioning as intended. At the centre of these controls is the contract or the contribution agreement with the Canadian executing agent (CEA) selected by CIDA to deliver its projects. Audits requested by CIDA's project managers are an important financial control used by the Agency. Once requested, the audits are commissioned by CIDA's Contract and Contribution Audit Unit (CCAU). We examined the audit findings on compliance with financial conditions in contracts, and reviewed the action CIDA had taken to deal with them. We selected a sample of 45 projects from CIDA's Geographic and Canadian Partnership branches. Our specific objectives were to:

- examine CIDA's financial controls over non-goods procurement contracts and contribution agreements and assess whether they are functioning as intended;
- examine and assess the actions taken by CIDA to deal with the results of contract and contribution audits, and assess the extent to which CIDA is recovering money identified by those audits as owed to it; and
- examine the role of the Performance Review Branch in reviewing whether financial controls for contracts and contribution agreements are functioning effectively.

More information on how we approached the audit is presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Project Financial Controls

A number of elements make up CIDA's financial controls over projects

28.13 Most of CIDA's projects in recipient countries are delivered through contracts and contribution agreements with Canadian for-profit and not-for-profit organizations who act as Canadian executing agents (CEAs). CIDA is accountable for the selection of its contract partners and the actions taken to develop and manage its agreements with them. The executing agent is responsible and accountable for delivering the project according to the terms of its contract with CIDA. Within CIDA, project managers are accountable for obtaining development results as described in project approval documents, in conjunction with Canadian and recipient country partners. They are also responsible for monitoring and reporting on project performance, and for communicating expected and achieved results.

28.14 CIDA has put in place various financial controls to support its project managers and their teams in planning and monitoring the implementation of projects. These controls include:

- project approval documentation (PAD);
- project budgets and schedules;
- financial risk assessments;
- contracts or contribution agreements;
- project implementation plans;
- work breakdown structures (WBS);
- reviews of claims and advance payments;
- project progress reports and financial reports;

- project monitors;
- annual project performance reports;
- Aid Information System (AIDIS);
- contract and contribution audits; and
- project audits.

A more detailed description of these elements of financial control is contained in the Appendix to this chapter.

28.15 The contract itself is at the core of financial control over projects. It stipulates what CIDA expects from the executing agent in delivering the project, and the terms of payment. It also specifies what information CIDA requires for managing the project, and defines the financial controls it will use to monitor the project.

Projects were approved at the appropriate level

28.16 The level of approval required for a project depends on its dollar value. Projects between \$500,000 and \$5 million require approval by a vice-president; the Minister's approval is needed for projects between \$5 million and \$15 million; and projects over \$15 million must be approved by the Treasury Board. We found that all projects in our sample had been approved by the appropriate authorities. The budgets presented in the contracts were consistent with those specified in the project approval documentation.

Assessments of financial risks are not always sufficiently taken into account

28.17 CIDA established the Financial Risk Assessment Unit (FRAU) in December 1992. Initially, the unit was to provide support to the Canadian Partnership Branch in assessing non-governmental organizations and institutions. The role of the unit subsequently evolved to include assessing a CEA's financial viability and capacity to execute a project. In 1998–99, the unit

carried out more than 200 risk assessments. The risk assessments are intended to ensure that the responsible CIDA officers are aware of:

- the level of financial risk associated with entering into a contribution agreement or contract with an organization;
- the means by which CIDA can limit or mitigate financial risk; and
- how CIDA will protect its investment in the program or project if the CEA runs into financial difficulties.

28.18 Most financial risk assessments are of not-for-profit organizations. In general, over 90 percent of these assessments consist of an analysis of the organization's financial statements. Where an organization is considered financially weak, project managers can decide to have the FRAU undertake a more in-depth assessment. These represent less than 10 percent of all assessments and include reviewing the CEA's financial management capability, accounting and financial reporting systems, and banking and financing arrangements, and determining whether the organization has taken appropriate corrective action to improve its financial position.

28.19 In the project files we examined, there were six organizations on which FRAU had conducted an assessment. It assessed the financial viability of four of the organizations as a high risk. FRAU made recommendations on ways to mitigate financial risks in these four cases, and in another that was assessed as a low risk. Recommendations of three of the five assessments were not implemented by the project managers. The reasons for this were not documented. We noted that in two of the three contribution agreements, subsequent audits by the Contract and Contribution Audit Unit (CCAU) revealed problems that could have been avoided if the FRAU recommendations had been implemented.

CIDA's contracts with its executing agents are at the core of financial control over projects.

28.20 CIDA should require that when project managers choose not to accept the recommendations of financial risk assessments, they document their reasons.

Agency's response: CIDA will require that project managers document the rationale for not implementing the recommendations made by FRAU.

Actual and planned expenditures are closely monitored

28.21 Project managers use CIDA's Aid Information System (AIDIS) to monitor and control project spending. The system provides information on project budgets, including details on annual planned expenditures and on actual expenditures based on advances and payments against claims submitted by CEAs. CIDA project teams review requests for advances and expenditure claims to ensure that they are consistent with the contract and the CEA's budget for the project. This verification involves procedures such as ensuring that services are in accordance with the contract and that costs are legitimate, reasonable and related to the request for payment. In several cases we observed, CIDA's project teams had adjusted claims pending receipt of further information because they believed that the claims were not in accordance with the contract. Verification is generally limited to the documents provided by the executing agents. The project manager can also request an audit to ensure that the expenditure claims are properly supported and are consistent with the terms and conditions of the contract.

28.22 Contracts usually require CEAs to provide financial reports on a quarterly and an annual basis. These reports compare actual expenditures with budgeted amounts by element of expenditure — such as staff salaries, consultants' fees, allowances, travel expenses, procurement and so on. CIDA's project officers review these reports to

determine whether spending is consistent with what was budgeted for that period and whether significant variances are explained. This permits CIDA to manage the flow of funds within projects effectively, and to reallocate funds to other projects as needed.

It is difficult to link financial information with information on project progress

28.23 Not all projects call for the same type or frequency of reporting in order for CIDA to be able to manage effectively. What is important is that a reporting approach be identified at the planning stage, agreed upon with the CEA, reflected in the contract, and respected. Any subsequent major changes to the monitoring approach and reporting requirements need to be reflected in an agreement with the CEA. In simplest terms, reporting needs to be structured so that CIDA can know what has been achieved for the payments it has made. This requires the setting of realistic targets and milestones as well as concise reporting by output or activity.

28.24 CIDA's guidelines to project managers point out that the nature of a project, its size, the degree of risk inherent in the project, and the delivery mechanisms are all factors in determining the most appropriate means of measuring and monitoring project performance. Other important factors include CIDA's experience with the recipient country and with the CEA. CIDA's project managers receive information on progress from a number of sources; the most important are the regular reports from the CEA. Other sources of information include an external project monitor who provides advice on the implementation and management of the project; the CIDA field representative assigned to the project; and the recipient governments or organizations. Progress reports are to identify and explain any significant variances from planned spending and progress. Narrative information on progress and financial

information are to be submitted and reviewed together whenever possible, so that progress toward expected results can be compared with the portion of the budget spent on each related activity. The analysis of information in the progress reports can indicate the need for decisions about any remedial action that the CEA, CIDA and/or the recipient country need to take.

28.25 Progress reports from executing agents vary in their content, frequency and format, depending on the project's size, complexity and potential risk. CIDA's guidelines call for reporting to include accomplishments (progress toward achieving outputs), time elapsed against the project's schedule, and costs compared with the budget for each output/activity. Typically, the contract requires that financial reports contain a summary of project expenses to date compared with the budget for the same period, and explanations of significant variances. Progress reports are to describe activities that have been completed in comparison with what was planned, with an explanation of significant variances. The CEA reports that we observed often did not compare actual accomplishments with what had been planned. External project monitors reviewing the implementation of projects have made similar observations,

as Exhibit 28.2 shows. It also shows that when project managers make it clear what information they require, progress reports improve.

28.26 Because the regular quarterly progress reports we reviewed did not compare planned with actual operational progress, project managers could not readily determine the project's rate of progress or, if progress was not as expected, the financial implications. CIDA has put in place a process for reporting annually on all projects over \$100,000. The Annual Project Progress Report compares actual expenditures to date with the total budget approved for a project, and gives estimates of accomplishments against expected results in percentage terms. This permits a basic comparison each year between the rate of expenditure and the rate of progress. It also provides CIDA with a picture of spending and progress for the portfolio of projects in a country. This report does help to flag problems but, because it is prepared only once a year, it is not timely enough to alert project managers to a rate of spending that is higher than expected relative to progress.

28.27 There can be many events that affect project success. Some may be beyond CIDA's control, such as a failure by the recipient organization or country to

**The progress reports
that we reviewed often
did not compare actual
accomplishments with
what had been
planned.**

In the case of a \$10 million project for institution strengthening and capacity building, the project monitor reported, "A recent quarterly report contains 26 pages of detailed tables but does not tie in financial results to project results"; "reports and work planning focus on activities and not results"; "no relationship between costs and results has been identified...it is very difficult to tell whether the relationship between costs and results is reasonable."

After reviewing a \$3 million project for capacity building in health reform, another monitor observed, "The main concern with this [progress] report is that it largely fails to provide a concise analysis and summary of whether the project is basically on track or not, which results have not been achieved on schedule and the reasons and what corrective actions could be made to redress the situation."

In the case of an \$8 million project to upgrade the teaching capacity of a university-level institute, the monitor commented, "The reports were brief and to the point and provided a snapshot of the last quarter reported. In addition, a graphical summary of trainees by year was provided. This will make tracking and completion dates of the trainees much easier to follow for all concerned. These new reports should add considerably to using the reports as a management tool."

Exhibit 28.2

Examples of Project Monitors' Comments on Project Reports

It is essential that project managers obtain sufficient information to know a project's financial status relative to its progress.

In some cases, a project had three or four managers over a five-year period.

deliver on commitments. Even so, CIDA needs to analyze the financial implications of variances from planned progress, whatever the cause, in order to assess the impact of the problem. A considerable portion of contract costs for large, labour-intensive projects are "fixed costs" in the host country for items such as project management, fees and expenses of CEA staff and office expenses. These can exceed 50 percent of a project's budget. Once a project is launched on site, CIDA's contract requires it to continue paying the CEA's costs even if the expected progress has not been made. It is considered a cost increase if a project cannot achieve the expected results without a budget increase, or cannot be completed within the approved budget unless its scope is significantly decreased. Such cost increases must be approved by the appropriate management level. For this to happen, under its results-based management approach CIDA must have good information on actual costs and progress, and regularly compare this with what was planned.

28.28 It is not always practical for project managers to conduct regular on-site visits of all the projects for which they are responsible. This makes it essential that they be able to obtain sufficient information from the CEA to know the project's financial status relative to its progress. CIDA is thus very dependent on the quality and integrity of the information provided by CEAs. Exhibit 28.3 illustrates a project where the lack of information on spending and progress created problems in managing the project.

28.29 We noted that in its transition to a results-based management approach, CIDA made efforts to improve its project planning and reporting. We observed that it made considerable efforts to ensure that the CEAs would understand and implement the new requirements of results-based management. Documentation in the files we reviewed

showed extensive internal and external communication on the planning and reporting formats for results-based management. In more recent contracts, we found more consistent references to, and listings of, expected outputs and the activities required to achieve them. However, the contracts did not tie the delivery of these outputs to CIDA's payments to the CEA, and did not always call for reporting of expenditures against these specific activities. Project reporting still needs to improve in reflecting actual accomplishments so that financial and operational progress reporting can be properly linked.

28.30 CIDA should ensure that project progress reports include information on planned and actual accomplishments. The financial implications of variances between planned and actual progress should be analyzed so that CIDA can assess whether the project budget should be increased to achieve the expected results or the project scope reduced to stay within the approved budget.

Agency's response: CIDA, in May 1999, published a Guide to Project Performance Reporting: For Canadian Partners and Executing Agencies, which clearly articulates these reporting requirements. CIDA will ensure that the principles of this guide are followed by project managers.

Frequent staff rotation affects project monitoring

28.31 CIDA project managers are accountable for the performance of the contractors on their projects. It is sometimes difficult for them to monitor performance and enforce the terms of a contract. One reason is that continuity in project management is interrupted by the reassignment of personnel within CIDA. In the projects we examined, replacements were often unfamiliar with the objectives and requirements of particular contracts. During the life of some projects,

responsibility for them changed hands several times. In some cases, a project had three or four project managers over a five-year period.

28.32 CIDA guidelines recognize that poor handover of project responsibilities will certainly affect the operation of the project team and may negatively affect the planning or implementation of the project itself. We found that some project managers had provided useful transition

letters for their successors. Others seemed to provide very little or no documentation, which suggests that the new project managers may have had to start from scratch in order to understand the project. Our review also found that program/project files were not structured in a way that easily provided for a continuous assessment of progress, related expenditures incurred, problems, and actions taken to ensure the project's continuity and efficiency.

Exhibit 28.3

The Lack of Information Comparing Spending With Progress Led to Project Management Problems

In 1997, a \$3.3 million project was proposed to CIDA to help establish lasting settlements for refugee families, mainly through housing construction. The project was to last for 14 months, ending in November 1998. Similar projects had been undertaken in that country since 1995 by many members of the international donor community.

A \$3 million contribution agreement between CIDA and the CEA was signed in September 1997. The agreement also specified the CEA's reporting requirements, including quarterly progress reports by activity and quarterly financial reports, as well as explanations of variances between planned and actual progress. The agreement also specified six specific outputs for the project.

In October 1997, the CEA presented its management plan for delivering the proposed project. The plan provided a detailed work breakdown structure linked to expected outputs, and a timetable for all activities to be carried out.

The three quarterly reports prepared by the CEA described a number of detailed tasks performed and some results obtained, but did not link them to planned activities or expected results. The reports also provided a summary of the actual expenditures to date compared with the total budget for the project. However, there was no comparison of actual expenditures with the budget for that period, nor were actual activities compared with those planned.

The work breakdown structure and the timetable, the two management tools prepared at the planning stage of the project, were not used in reporting on activities and results of the project.

The quarterly report for the period ended 30 September 1998 was the third and last quarterly report submitted by the CEA prior to filing the end-of-project report in June 1999. As of 30 September 1998, the CEA reported that it had spent 52 percent of the total budget.

Until the third quarterly report, the CEA had always reported that the project was progressing within budget, and that it would end as expected in November 1998. However, in its third report on 29 October 1998, the CEA requested a budget increase of \$235,000 and informed CIDA that the project would end one month later than expected, in December 1998.

In January 1999, CIDA learned that the CEA had actually spent the requested additional budget without having received CIDA's authorization. At CIDA's request, on 18 January 1999 the CEA provided details on additional activities and costs to support its request for a budget increase. Given the circumstances, CIDA informed the CEA on 27 January 1999 that it agreed to increase the budget to cover the shortfall. However, on the next day, CIDA informed the CEA that it had been informed by CEA staff that the proposed budget increase was not sufficient because the CEA had already incurred expenditures well beyond that amount. CIDA indicated to the CEA that again it was open to a request for an additional budget increase.

In March 1999, CIDA and the CEA signed an amendment to the contribution agreement, increasing the budget by \$605,000. This represents a 20 percent increase from the original budget amount. In the revised agreement, three outputs budgeted originally for \$560,000 were cancelled after \$32,000 had been spent on them. Three new outputs were added, but the amounts to be spent on them were not identified.

The CEA presented its final report in June 1999. The full revised budget of \$3.6 million had been spent.

28.33 We are concerned that the high rotation of project managers, inadequate transition documents and poorly kept files increase the difficulty of maintaining control over the management of projects. An appropriate transition process would help to reduce this difficulty.

28.34 CIDA should ensure that project managers who are reassigned understand the importance of preparing and providing to their replacements key project implementation documents, including a realistic assessment of a project's status in terms of its progress against its expenditures, and any significant issues affecting project delivery.

Agency's response: CIDA will revise its ROADMAP guidelines to better guide the transition process between project managers so that continuity and stability of the project's implementation can be maintained.

A new information system is expected to improve financial management

28.35 Recently CIDA introduced a new Aid Information System (AIDIS) that envisions building a foundation for more effective management of the Agency's development programs. It is intended to be compliant with the new government-wide Financial Information Strategy (FIS), which is designed to link financial and management information.

28.36 CIDA expects that AIDIS will provide it with a greater capability to manage its projects and resources. The new system is being designed to incorporate project, contracting and financial management information. One of its intended key features is improved corporate reporting by branch, program and division and by project, supplier and status. CIDA officials expressed confidence that the system would meet the operational requirements of results-based management.

28.37 AIDIS is being introduced in three phases. Phase I went live on 1 June 1999. Phase II is expected to be completed by 1 April 2000 and to provide CIDA with the necessary functions to manage all projects from start to finish. With Phase III, the Agency expects to meet FIS requirements. The timeframe for this phase is driven by the government's target, which is to have FIS operational on 1 April 2001.

Dealing With the Results of Audits

Audits reveal some persistent problems of non-compliance with contract conditions

28.38 CIDA has put in place a program of annual audits to examine whether expenditures by CEAs comply with contract conditions. CIDA's program branches select projects for audit. The headquarters Contract and Contribution Audit Unit (CCAU) then arranges to have the audits conducted by independent audit firms. The CCAU also randomly selects some contracts for audit. In our discussions with project managers, they consistently mentioned to us that they use these audits for assurance that financial conditions in contracts are being respected.

28.39 About 100 to 115 financial audits are requested each year by project managers, and CCAU also randomly selects about 10 contracts to be audited. These audits are commissioned by CCAU at an annual cost of about \$2 million. However, in the period covered by our audit (between 1995 and 1998), we noted that only about half of CCAU's selected contracts were audited. Annually, the audits covered about \$238 million in expenditures by CEAs, going back to the start of the contract or the date of a previous audit. When an audit reveals instances of possible non-compliance with contract conditions, the auditor identifies the item as a possible overpayment requiring an adjustment by CIDA. On

average, auditors propose adjustments totalling about \$8.1 million annually.

28.40 Overall, the audit reports we examined indicated that, to a large degree, expenditures were in accordance with contract conditions. The amounts identified as possible adjustments because of non-compliance with contract conditions were relatively small — \$32.2 million out of about \$932 million audited over four years. However, the reports frequently proposed dollar adjustments based on non-compliance with some conditions over the life of the contract. The most frequent reasons for proposed adjustments were:

- expenditures made without CIDA's prior approval;
- lack of supporting documentation; and
- unreported interest earnings on advances.

Of the 45 audit reports we examined, 37 raised one or more of these observations.

28.41 Many adjustments were proposed because the required prior approvals from CIDA for claimed expenses were not available at the time of the CCAU audit. In most of these cases, approval from CIDA was obtained only after the expenses had been incurred.

28.42 Contracts require that all expenditure claims submitted to CIDA be appropriately supported. However, contracts are silent on the specific kind of support required from CEAs to substantiate the expenditures they claim. A standard clause specifies that CIDA will pay for the time allocated to the project's activities by employees and consultants or for the "time actually worked". Audit reports indicated that in many cases the salaries and fees charged by the executing agents could not be verified, because there was no documentation of time actually worked on the project.

28.43 In some contracts and contribution agreements, specific clauses allow for CIDA to make cash advances to CEAs to cover immediate costs of delivering their projects. Such advances must be supported by a forecast of estimated costs. Contracts and contribution agreements require that these advances be deposited in a separate interest-bearing bank account wherever possible, and that all interest earned be credited to the project. In the case of a contract, interest, if material, is to be recovered by CIDA or used to reduce its future payments under the contract. For contribution agreements, the interest is not recovered by CIDA and is to be used for the purposes of the contribution.

28.44 Auditors reported that in some cases, interest revenue had been calculated and recorded in accordance with the contract. In many cases, however, interest clauses were not respected. The most common observations were the following:

- advances were not deposited into a separate interest-bearing bank account and no interest revenue was accounted for;
- the CEA did not have a separate bank account for the project and it was practically impossible to determine the amount of interest earned;
- the interest earned was related to the CEA's own deposit in the project account and thus no interest had to be reimbursed to CIDA.

28.45 The contracts audited for the CCAU were not always clear on what expenditures were to be included in fringe benefits and overhead and thus charged to CIDA. Where contracts were silent or ambiguous, auditors did not raise this issue because there was no contract clause with which to verify compliance.

28.46 The lack of clarity in contract clauses related to fringe benefits and overhead can result in double payments by CIDA to CEAs. In most contracts, the

**Lessons learned from
audits were not
presented to senior
program managers for
action.**

calculation of fringe benefits and overhead to be paid by CIDA is based on salaries. Contract clauses specify the percentages to be used in this calculation. Some contracts indicate that fringe benefits include the payment of salaries when CEA project personnel are not at work because of vacation, statutory holiday or sick leave. This means that the per diem rate billable to CIDA includes a mark-up for these fringe benefits. However, in some instances, audit reports identified a double payment by CIDA because CEAs had claimed and been paid for time not worked by employees although these benefits were already included in the CEAs' per diem rates.

28.47 CEAs are responsible for purchasing and using assets (vehicles, furniture, etc.) for the duration of the project. They are also responsible for disposing of these assets at the end of the project. However, contracts do not always specify how, after their purchase, the use of these assets should be controlled and reported during the project and disposed of at the end. Some examples of lack of reporting include the following:

- project vehicles were used by personnel working on the project, but their use was not reported. No benefit was added to the salary of the employees who used the vehicles for personal reasons, although this is required; and
- assets purchased for the project were sold at the end of the project and the proceeds from their sale were not reported.

28.48 From 1992–93 to 1997–98, the CCAU prepared three biannual reports summarizing its activities and results. These reports identified the types of adjustments raised in audits and suggested lessons to be learned from recommendations in the reports. Many of the same issues were raised in all three reports. We noted that these reports and the recommendations in them were not

presented to senior program managers for action.

28.49 In July 1999, CIDA approved a policy on overhead rates to be paid under contribution agreements and non-competitive service contracts. This is one of the issues that the CCAU had consistently reported as a problem area since 1992–93. However, no action has been taken to deal with the remaining problems identified in its reports.

28.50 CIDA should ensure that the Contract and Contribution Audit Unit presents its biannual reports to senior program management for action, and that the adequacy of the actions taken to respond to its recommendations is periodically reviewed.

Agency's response: The biannual reports of the Contract and Contribution Audit Unit will be presented to senior management for review and approval.

The release of dollar adjustments is not always adequately justified

28.51 Although audit reports indicated that expenditures by CEAs were largely in compliance with contract conditions, they also identified a number of areas of possible non-compliance where proposed adjustments needed to be examined.

28.52 Project managers are accountable, in collaboration with the CCAU, for following up the audit reports on their projects. The manager must assess the accuracy and appropriateness of all the audit adjustments and negotiate the recovery of funds from the CEA. In some cases, the gathering of supporting documentation and the negotiation process can be quite lengthy and time-consuming for both CIDA staff and the CEAs, due to the large numbers of adjustments that are proposed. The average length of time between the date of the audit report and the date established for recovery of adjustments was about eight months, with the longest about 29 months. At the end of this process, about 65 percent of proposed

adjustments are released and consequently not reimbursed by CEAs.

28.53 Adjustments can be released for a number of valid reasons:

- missing supporting documentation is subsequently provided by the contractor;
- the project manager recognizes that the CEA's interpretation of a contract clause and not the auditor's is the correct one; and
- confirmation of prior approval is subsequently obtained.

28.54 The supporting rationale for releasing audit adjustments was documented in most of the audit reports we reviewed. Often, adjustments were released because CIDA found the contract wording ambiguous and did not want to enter into a dispute with the CEA. However, we believe that the reasons given for the release of adjustments were not always justified — for example, in projects involving a lack of records for time actually worked by employees and consultants, and personal use of project vehicles.

28.55 We also felt that the release of many adjustments related to travel expenses, such as airfare, hotel accommodation and others, was not adequately justified. In many cases, CIDA accepted claims for airfares that were higher than allowed in the Treasury Board travel directive. In one instance, an adjustment of \$19,262 was noted for double payment of salaries. CIDA released the adjustment but there was no supporting explanation on file.

28.56 We also noted some instances where project managers had entered into discussions with CEAs to release dollar adjustments rather than applying the provisions of the contracts. Exhibit 28.4 illustrates this type of situation.

28.57 Overall, based on the audit reports in our sample, we estimated the amounts released without sufficient justification to be \$12 million to \$13 million over the four years of reports we examined. We recognize that these amounts are relatively small when compared with the total amounts of the expenditures audited. However, in the interest of fairness and because most

In a \$686,000 project, the audit report identified an adjustment of \$471,000 because of lack of support for the fees charged by the CEA. The CEA had no system to verify the actual time worked on the project.

The CEA argued that it earned its revenues from the results it produced, not the time it billed for a project. However, the contract tied CIDA's payment not to results but to fees for staff carrying out the project. CIDA nonetheless accepted the CEA's explanation for time charged by its staff. There was no documentation on file supporting this time allocation, although CIDA was aware that CEA staff were also working at the same time on other projects in Canada and abroad, one of which was funded by CIDA.

In another case, CIDA's share of a \$585,000 project was 51.2 percent of acceptable expenses, to a maximum contribution of \$300,000. The recipient indicated that it had spent \$656,000. An audit of the contribution agreement before CIDA's final payment identified an adjustment of \$498,000 because of a lack of support for amounts claimed as salaries by the company's shareholders. The company did not have a system for recording time worked. The audit noted that the amounts claimed for salaries had not actually been paid, but were based on the notional value of fees that the shareholders allocated to themselves for the time they worked on this project, one of three projects in which they were involved at the same time.

After discussions with the company, CIDA accepted this explanation and made the final \$43,000 payment. The allocation for time worked on the project was never adequately documented.

Exhibit 28.4

Audit Adjustments Released Without Adequate Justification

**CIDA needs to be more
insistent about
challenging
non-compliant
expenditures.**

**The Performance
Review Branch needs
to be more active in
auditing whether
financial controls are
functioning effectively.**

expenditures by CEAs are in accordance with contract conditions, we believe CIDA needs to be more insistent about challenging CEAs whose expenditures have been identified as non-compliant.

28.58 CIDA should clarify its standard contract clauses to reduce ambiguity. Where the wording in a contract is clear, CIDA should maintain adjustments unless recovery of the funds is clearly not cost-effective.

Agency's response: CIDA will clarify standard contract clauses and will develop guidelines to help project managers determine whether audit adjustments should be recovered or released.

Adjustments that are maintained are recovered

28.59 In our sample of 45 audit reports we found that CIDA did recover the audit adjustments that had not been released. We found that these amounts were fully recovered in all but two cases where money was owed. Either the executing agencies paid the full amount owed by cheque or CIDA deducted the amounts from progress payments owed to the executing agents under the same contract or contribution agreement. Interest owing in accordance with Treasury Board regulations was not always charged or collected.

28.60 In two cases, we found that the funds were not recovered or were only partly recovered. In one case involving \$452,505, CIDA believed that the CEA's financial situation made it impossible to recover the funds. It still hopes to recover at least some of the amount outstanding at a later date, should the CEA's situation improve. We were told that this case is being monitored by the Agency. The other case was related to annual program funding of a not-for-profit organization. The amount was insignificant. CIDA decided that the organization should keep the funds on the understanding that it

would spend them on its aid program in the future.

The Role of Performance Review

A need for more active audit of financial controls

28.61 In 1994, CIDA's Performance Review Branch was assigned the lead role in developing and implementing results-based management across the Agency. The work plans of the Performance Review Branch reflect this. As a result of the emphasis on results-based management, there was no emphasis on internal audits of management systems such as those related to financial controls. Branch plans did not include any audits of financial controls for contracts and contribution agreements although, to avoid potential overlap or duplication, the Performance Review Branch took the compliance audits managed by CCAU into account when it prepared its annual work plan. However, the Performance Review Branch does not audit or assess the coverage and selection of the contract and contribution audits or the adequacy of resulting follow-up actions taken by program managers.

28.62 In our view, there is a need for the Performance Review Branch to play a greater role in assessing whether audits of contracts and contribution agreements are providing the level of financial control expected by CIDA. As part of its audit program, the Branch needs to examine whether findings and recommendations from CCAU audits are fed back to CIDA's management so it can apply the observations to the rest of the Agency's operations.

28.63 Another important financial control involves the financial and progress information provided to CIDA by the CEAs who deliver aid projects. It is essential that this information be meaningful and accurate. Here, too, we believe that the Performance Review Branch needs to be more active in

auditing whether CIDA is receiving the kind of information needed to support good project management.

28.64 The Performance Review
Branch needs to periodically assess the audits of contracts and contributions to determine whether they are providing the required level of financial control.

Agency's response: The Performance Review Branch will include, on a cyclical basis, the audit of the Cost and Contribution Audit Activity as part of its Internal Audit Plan.

28.65 The Performance Review
Branch should include in its future work plans an audit of the quality and accuracy of financial and progress information reported by Canadian executing agents.

Agency's response: In the periodic conduct of internal audits of financial management, the Performance Review Branch will include in the scope of these audits the quality and accuracy of financial and progress reports.

Conclusion

28.66 We concluded that CIDA's financial controls were effective in monitoring and controlling the flow of funds for projects. The Agency had good information on its expenditures, and on what remained to be spent on projects.

However, it was difficult to link expenditure information with information on operational progress. Progress reports tended not to describe actual accomplishments in relation to what had been planned. This made it difficult to carry out a timely analysis of the financial implications if progress was not as expected. The result was a risk that project scope would have to be reduced or the budget increased in order to accomplish intended objectives.

28.67 The contract is the key document for financial control over projects. CIDA uses audits for assurance that the financial conditions in its contracts are being respected. Overall, audits show a high level of compliance, although there are some persistent problems that need to be addressed. In the cases we reviewed, we believe that CIDA's project managers needed to be more insistent about challenging CEAs whose expenditures were identified as non-compliant with the terms of their contracts. However, once CIDA had determined that an amount was owed, its procedures for recovery were good, with minor exceptions. Lessons learned from the information generated by audit reports were not being fed back to program managers to make the changes needed to correct recurring problems.

28.68 At the corporate level, CIDA needs to periodically assess whether financial controls are providing the expected support to project managers.



About the Audit

Objectives

Our objectives in this audit were to:

- examine CIDA's financial controls related to non-goods procurement contracts and contribution agreements and to assess whether they are functioning as intended;
- examine and assess the actions taken by CIDA to deal with the results of contract and contribution audits, and assess the extent to which CIDA is recovering money identified by those audits as owed to it; and
- examine the role of the Performance Review Branch in reviewing whether financial controls for contracts and contribution agreements are functioning effectively.

Scope and Approach

The audit focussed on the financial controls CIDA has put in place for managing its development projects. At the centre of these controls is the contract and contribution agreement with the Canadian executing agent selected by CIDA to deliver its aid projects. The projects we selected were non-procurement projects that had already been approved by CIDA.

Audits commissioned by CIDA's Contract and Contribution Audit Unit (CCAU) are an important financial control used by CIDA. The CCAU is a headquarters unit that arranges for audits by independent audit firms. The auditors examine expenditures of projects for compliance with financial conditions in contracts and contribution agreements. The projects to be audited are selected by the program branches based on CCAU criteria such as size, risk, contractor experience, etc. The Unit itself also randomly selects a certain number of contracts for audit. About 100 to 125 audits are conducted annually.

To carry out our audit, we selected at random 45 contracts and contribution agreements that had been the object of CCAU audits between 1995 and 1998. We did not redo the audits that had been carried out. Rather, we used them as a basis for examining the actions taken by CIDA to deal with the results of these audits and for examining whether CIDA was recovering any money identified by audits as owed to it. We also used 30 projects from this sample to examine the functioning of financial controls over projects. To ensure that the projects we examined reflected CIDA's current approach to project management, we also judgmentally included 15 more recent projects that had been audited in 1998–99. We selected these on the basis of their size and in order to include projects from the Geographic and the Canadian Partnership branches. Because the reports from these audits were still being discussed, we did not include them in our analysis of how CIDA deals with the results of audits.

We conducted our work at CIDA's headquarters. We reviewed project documentation and audit reports and held discussions with CIDA officials.

Criteria

Our audit criteria were largely derived from CIDA's internal guidelines and from the sound controls one would expect to find in place.

Basic financial controls

Project planning, analysis and approval documentation should contain the financial information and assessments called for in CIDA's program and project management framework.

Financial information in contracts and contribution agreements should be consistent with that in project approval documents.

Changes to project costs should be approved by the appropriate decision-making authority. These should also be reflected in amendments to contracts and contribution agreements.

Progress and financial reports should be submitted as called for in contracts and contribution agreements. Financial reporting should be linked to activities described in contracts and contribution agreements.

Information from performance monitoring reports and reviews should be used as required for management decision making and taking corrective action on projects.

Financial information should be linked to information on project progress. The financial implications of variances from planned progress should be analyzed.

Decisions to release audit adjustments should be appropriately supported and taken at the proper decision-making level.

CIDA should analyze issues identified in audit reports and take corrective action as needed.

Recovery of money

“Maintained” audit adjustments should be set up as receivables and recovered by CIDA.

A decision to write off amounts to be recovered should be documented, explained, and taken by the appropriate decision-making authority.

Records of amounts recovered should be kept.

Role of performance review

CIDA should assure itself that the elements that make up its financial control framework for contracts and contribution agreements are functioning effectively.

Audit Team

Assistant Auditor General: David Rattray

Principal: John Hutchinson

Director: Manfred Kuhnapfel

Elizabeth Burges

Eve Dufresne

Johane Garneau

Jacques Marquis

Paul Morse

Barry Neilson

For information, please contact John Hutchinson.

Appendix

CIDA's Financial Controls Over Projects

Project approval documentation (PAD). The PAD documents include the project proposal, tentative budget, and logical framework analysis.

Project budgets and schedules. These include estimates of the cost of each of the proposed project outputs. Initially, the budget is included in the project approval document (PAD). Later, it plays a critical role in the financial control of the project.

Financial risk assessment. The financial viability of the selected Canadian executing agent (CEA) is assessed by the Financial Risk Assessment Unit (FRAU) for all contribution agreements with not-for-profit organizations that receive \$200,000 or more per year and for all contracts with for-profit organizations where the fee component is estimated to exceed \$1 million.

Contracts or contribution agreements. These govern how a CEA implements a project. They include project objectives and scope, budget, payment schedules, terms of payment and reporting requirements.

Project implementation plan. This is usually prepared within a few months of the signing of the contract or contribution agreement with the CEA. The report documents the degree to which the original assumptions, objectives, activities, schedules and budgets are still valid, and/or recommends changes where required. The report usually provides an updated and more detailed plan on how the CEA intends to implement the project. In addition to operational and technical issues, the report also focusses on the financial management, administration, control and reporting aspects of the project.

Work breakdown structure (WBS). This work plan breaks a project down into the activities required to produce each desired output, and describes their interrelationship.

Project progress and financial reports. These are used to assess progress toward planned results, and to compare expenditures with the approved project budget.

Project monitor. A Canadian or local project monitor may be engaged to independently review and report to CIDA on project performance. The monitor reviews narrative reports on progress and financial information, and usually undertakes site visits to observe actual progress. The monitor may also advise on technical issues involved in implementing the project.

Annual Project Progress Report. This report is the basic tool for tracking projects over \$100,000. The report includes information on project expenditures, expected and actual results (outputs, outcomes and impacts), lessons learned and progress ratings.

Aid Information System (AIDIS). This system provides the information on overall budgets and expected and actual annual expenditures that is needed to monitor and control projects.

Contract and contribution audits. These are audits for compliance with contract conditions that are requested by project managers and commissioned by the Contract and Contribution Audit Unit (CCAU).

Project audits. These are project management audits by the Internal Audit Division of the Performance Review Branch. These audits cover management practices, operations, systems and controls, and the achievement of intended results.

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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 30
**Sole-Source Contracting for Professional Services:
Using Advance Contract Award Notices**

November 1999

Report of the
Auditor General
of Canada
to the House of Commons

Chapter 30

Sole-Source Contracting for Professional Services:
Using Advance Contract Award Notices

November 1999

This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 30

**Sole-Source Contracting
for Professional Services**

**Using Advance Contract
Award Notices**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Sole-Source Contracting for Professional Services

Using Advance Contract Award Notices

Main Points

30.1 This chapter examines the government's practice of awarding sole-source contracts for professional services. It also examines a mechanism known as an Advance Contract Award Notice (ACAN), used widely by departments to advertise their intention to award sole-source contracts to a specific supplier.

30.2 The principles of accessibility, competition, fairness to suppliers, transparency and best value lie at the core of government contracting policy. The contracting regulations require that all contracts be let through a competitive process, with certain very narrowly defined exceptions. When the contract is needed in an emergency, when the value is small, when it is not in the public interest to solicit bids (for example, if national security is involved) or when there is only one supplier who can do the work, the contract can be let without competition on what is called a sole-source basis. Almost 90 percent of the 50 sole-source contracts we examined did not fall under any of the exceptions or did not have adequate evidence of doing so and hence ought to have been competitively tendered. As in last year's audit of sole-source contracts for professional services, we concluded that the process of awarding most of the contracts audited in this year's sample would not pass the test of public scrutiny.

30.3 We concluded that the ACANs associated with these sole-source contracts added transparency to directed contracting, because ACANs are publicly advertised (compared with the nearly 40 percent of sole-source contracts that are let without any public notice) and can be challenged before their expiry date. However, in our view the challenge process is flawed and discourages potential suppliers from submitting challenges. Only 35 of the 522 contracts that we reviewed had been challenged and only 4 of the challenges were accepted. We found the following:

- The information the ACANs provide is often vague and they are challenged infrequently. Furthermore, many ACANs are posted for less than the recommended 15 days. There is no policy defining the challenge process, nor any criteria for judging the validity of a challenge. Those who decide whether a challenge is valid are, for the most part, the same departmental officials who originally decided that the contract should not be open to competition. There is no recourse to appeal their decisions unless the contract is subject to trade agreements, in which case they may be appealed to the Canadian International Trade Tribunal. Mounting a challenge to an ACAN under these unfavourable circumstances requires the supplier to invest both money and good will, an investment that most find unattractive.
- Based on the 50 sole-source contracts selected for detailed examination, in most instances the decision to contract is not well considered, the requirements are often defined only vaguely, pricing is not done with due regard to economy and often deliverables are not assessed against the original requirements of the contract.
- The existing framework of contracting rules, policies and regulations for contracting is basically sound. However, the evidence shows that departments either do not understand this framework or in some instances choose not to follow it.

Background and other observations

30.4 In 1997, contracts of \$25,000 and above for all types of services (including professional services) had a total value of \$3.9 billion. Of that amount, \$1.34 billion was for sole-source contracts. An ACAN was posted for

over half of those (\$830 million) and the balance (\$510 million) were entered into without public notice of the government's intent to issue a sole-source contract.

30.5 Our December 1998 Report (Chapter 26 — Contracting for Professional Services: Selected Sole-Source Contracts) noted that the process of awarding most of the contracts in the sample we audited that year would not stand the test of public scrutiny. In May 1999, the Standing Committee on Public Accounts supported the audit findings and expressed concerns about departmental practices as they relate to ACANs.

30.6 The objective of the current audit was to assess the use of sole-source contracts and ACANs in professional services contracts by National Defence, Human Resources Development Canada, the Canadian International Development Agency and Industry Canada, and by Public Works and Government Services Canada on their behalf. Our audit included all 522 ACANs issued by, or on behalf of, the four departments in 1998, and examined in detail a sample of 50 of these.

30.7 We have made recommendations designed to encourage and strengthen the accountabilities in departments and agencies for the exercise of delegated contracting authority by managers. Additionally, to strengthen the challenge process for contracts, including contracts let using ACANs, we have recommended that the government clarify the due process rights of contractors and establish an independent appeal mechanism for contractors.

The Treasury Board Secretariat has indicated that the Treasury Board's contracting policies are based on the strong values and principles of competition, openness, equal access, transparency, fairness and best value for Canadians. It explains that the Board's role is to establish these policies and that departments, in turn, are accountable to their ministers and to parliamentarians for implementing them. The Secretariat commits to introducing a program of training and certification for procurement specialists as well as implementing a monitoring framework for evaluating contracting activities. While Treasury Board policy encourages contract review mechanisms and internal audits, the Secretariat does not believe that a mandatory policy requirement for a contract review mechanism in departments is necessary, nor does it support the recommended scope for internal audits of sole-source contracts. The Secretariat does not believe that an independent appeal mechanism for contractors that deals with contracts lying outside the purview of the Canadian International Trade Tribunal is necessary.

Introduction

Background to the current audit

30.8 Our December 1998 Report Chapter 26 reported on an audit of a sample of sole-source contracts for professional services. That chapter indicated that the audit was to be the first in a series of audits of contracts. This chapter reports on the second audit in that series. It continues our focus on sole-sourcing — in particular, on sole-sourcing for professional services. This audit also focussed on a relatively new addition to the federal government contracting regime: the use of Advance Contract Award Notices to give public notice of the government's intent to enter into a sole-source contract.

30.9 Contracting is an essential tool for federal departments and agencies in delivering programs. Central to government contracting are the principles of best value and open access to contracting opportunities. "Best value" is the best combination of value and price that the government can obtain in acquiring goods or services for the Crown. "Open access" is a fair chance for all qualified vendors to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

30.10 The Government Contracts Regulations state that competition is the norm, and departments are to solicit bids before entering into a contract. However, it is not always possible, practical or cost-effective to seek bids for every proposed contract. The regulations therefore allow the contracting authority, in certain well-defined circumstances, to set aside the requirement to solicit bids and instead to sole-source a contract. Specifically, the regulations permit the competitive process to be bypassed when there is a pressing emergency, the contract

is valued at less than \$25,000, it is not in the public interest to solicit bids, or only one person or firm is capable of doing the work. (When CIDA is contracting in support of an international aid project, its dollar exception is raised to \$100,000.) There is also a temporary exception related to contracts for printing services with the Canada Communications Group Inc. Provision for this expires in 2002 and none of the contracts in this chapter relate to it.

30.11 In 1999, following a public hearing on our 1998 audit report, the Public Accounts Committee issued *A Report on Contracting for Professional Services: Selected Sole-Source Contracts*. In its report, the Committee concurred with the former Standing Committee on Government Operations, our audit report, and the testimony of Treasury Board Secretariat officials that the existing rules governing sole-source contracting are sound but that stricter compliance by all government officials is needed.

30.12 The Public Accounts Committee made eight recommendations for improving the way sole-sourcing is managed. Among other things, it called on the Treasury Board Secretariat to monitor departmental contracting activities more closely. It also recommended that the Secretariat modify its rules to ensure that the use of Advance Contract Award Notices would enhance transparency and, where warranted, encourage challenge and thus increase competition.

30.13 In 1998, Public Works and Government Services Canada (PWGSC) completed an audit of its use of ACANs in awarding sole-source contracts that it issues on behalf of other departments. The audit's objectives were to determine compliance with the ACAN requirements of the Supply Policy Manual, and the extent to which, before posting an ACAN, PWGSC procurement officers validate the sole-source justifications provided by departments. The report concluded that:

Central to government contracting are the principles of best value and open access to contracting opportunities.

An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

- in 79 percent of a sample of 288 cases, there was no evidence on file that the procurement officer had made a determination as to the validity of the client's sole-source rationale; and
- more formal guidance is needed on the roles, responsibilities and accountabilities of both PWGSC officials and their clients for managing challenges to ACANs, especially when withdrawal of the challenge is a possibility.

30.14 In 1995, the Standing Committee on Government Operations recommended that the use of ACANs in sole-source contracting be reviewed to ensure that it promotes competition, access, fairness and transparency. The Committee also recommended that the Treasury Board exceptions to the requirement for open, competitive bidding be reviewed, to identify and reduce any tendency to bypass the competitive process by using ACANs. Finally, the Committee recommended that the Office of the Auditor General give special scrutiny to the use of sole-sourcing for government contracts.

The use of an Advance Contract Award Notice (ACAN) is meant to increase transparency.

The origin of Advance Contract Award Notices

30.15 ACANs were instituted in response to a complaint filed with the Procurement Review Board by a supplier in November 1989. The Department of Supply and Services (at that time) was required only to publish a notice within 60 days of awarding a sole-source contract. The complaint arose because the Department had awarded a contract without competition but had not published the required notice until 139 days after the fact. The Procurement Review Board (as it then was) heard the complaint in early 1990. It subsequently recommended that the Department review its policies on publishing notices of contract awards. The Board also recommended that the Department publish a notice *before* awarding a contract, indicating its

intention to contract on a non-competitive basis.

30.16 The Department adopted this recommendation and in May 1992 posted the first ACAN on the electronic bulletin board known as the Open Bidding System. The Department (now Public Works and Government Services Canada — PWGSC) has been using ACANs since that date. They are currently published on the successor to the Open Bidding System, an Internet site called MERX.

30.17 The use of an ACAN to publicly advertise the intent to award a sole-source contract is meant to increase transparency by alerting potential suppliers to the upcoming sole-source procurement. This gives them an opportunity to challenge the award by demonstrating that they are capable of performing the work. If the department rejects the challenge, its decision cannot be appealed, unless the contract falls within the ambit of one of three trade agreements — the Agreement on Internal Trade, the North American Free Trade Agreement (NAFTA), or the World Trade Organization-Agreement on Government Procurement. In that case, the supplier can appeal the decision to the Canadian International Trade Tribunal.

30.18 The policy on using ACANs has been evolving for several years. To reinforce its policy, the Treasury Board Secretariat sent a Policy Notice on ACANs to departments and agencies in March 1999. Among other things, it reminded departments that every ACAN is to be posted for at least 15 days to allow potential suppliers to challenge it. Any valid challenge to the proposed contract award must not be ignored. Furthermore, the Secretariat directed that the ACAN not include any statement to the effect that it is not a competitive bid solicitation. Treasury Board officials explained that in their view, suppliers see such wording as prohibitive, and excluding it from ACANs will encourage challenges.

Government uses ACANs to a significant extent when contracting for services

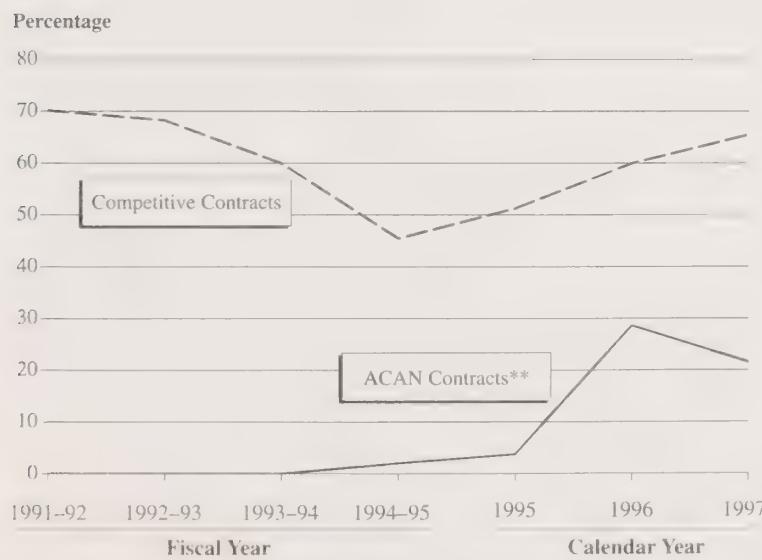
30.19 In 1997, contracts of \$25,000 and above for all types of services, including professional services, had a total value of \$3.9 billion. Of that amount, \$1.34 billion was for sole-source contracts. An ACAN was posted for over half of those (\$830 million) and the balance (\$510 million) were unadvertised. Initially, the use of ACANs was limited, as Exhibit 30.1 shows. However, in 1996 their use increased sharply; sole-source contracts accompanied by an ACAN now account for more than one fifth of all service contracts valued at over \$25,000.

30.20 The Treasury Board Secretariat's Contracts Policy provides that if the ACAN is posted for 15 days and is not challenged, the contracting authority is allowed to award a larger contract on its own authority than if the ACAN had not been posted. This incentive may explain the significant growth in ACANs since 1995.

Focus of the audit

30.21 The purpose of our audit was to examine a sample of sole-source contracts for professional services (not involving goods) where Advance Contract Award Notices had been used. We wanted to determine the extent to which the applicable policies and regulations, principles of government contracting and good contracting practices were followed.

30.22 We examined a sample of 50 such contracts for amounts greater than \$25,000. Each was advertised in an ACAN posted in the calendar year 1998. The sample was from four departments: National Defence (20 cases – 10 posted by the Department and 10 posted by PWGSC on its behalf), Human Resources Development Canada (10), Industry Canada (10) and the Canadian International Development Agency (10). Departments are permitted to let most service contracts directly, but may choose to request PWGSC to do so on their behalf. In those circumstances, PWGSC acts as the contract authority and is accountable for some aspects of the



* The threshold changed in fiscal year 1994–95 from \$30,000 and above to \$25,000 and above.

** Estimates limited by inconsistent collection of data.

Exhibit 30.1

Competitive and ACAN Federal Service Contracts Above the Sole-Sourcing Threshold*

In the Treasury Board's Annual Contracting Activity Reports, definitions changed from year to year. As a result, this information should be interpreted only as broadly indicative of trends.

Source: Treasury Board Annual Contracting Activity Reports
UNAUDITED

contracting process. This was the case for 17 of the contracts in our sample.

30.23 The sample was selected at random from a total of 522 professional service contracts over \$25,000 for which an ACAN was posted by one of the five departments in 1998. The 522 ACANs represent about 25 percent of the total number of ACANs posted by all federal departments. The sample represents nearly 10 percent of the population from which it is drawn, and generalization from it is fully warranted. A selection of case studies begins on page 30–11.

30.24 We focussed only on the actions of government officials as they entered into and administered these contracts. We did not audit the contractors, and we make no comment on their actions.

30.25 Further details on the audit and on where to find related information referred to in the text can be found at the end of the chapter in **About the Audit**.

Observations

30.26 As we did last year, in this chapter we present the results of our audit under each stage of the contracting process. These stages and the issues they raise are common to all sole-source contracts. However, each of these particular sole-source contracts was let using a process that included posting an Advance Contract Award Notice and providing an opportunity for potential suppliers to challenge it. The special issues raised by the ACAN process are discussed later in the chapter.

Stages of the Contracting Process

Screening to establish and define the need

30.27 The screening process is the stage at which the decision is made that a service is required and that contracting for it is the most economical way to proceed. Screening includes developing a clear statement of what the needed service entails and determining whether internal resources could provide it more economically than a contractor (whether to “make or buy”). We examined the contract files to assess the adequacy of the needs analysis, requirement definition and the make-or-buy decision (see Exhibit 30.2).

30.28 We found that the need for about one quarter of the contracts was neither adequately justified nor linked to program objectives. Failure to include these steps increases the risk that “wants” will not be adequately distinguished from genuine program “needs” and that available financial resources will not be used with due regard to economy.

30.29 In 95 percent of the cases, the screening practices we noted did not include an analysis of alternatives that was adequate to support the decision to contract. We were informed during

Exhibit 30.2

The Screening Process

Percentages of contracts in our sample of 50 that met or did not meet our criteria for screening.

Criteria	Met	Not Met
The need to acquire the services covered in the contract has been adequately justified and linked to program objectives.	75	25
There is evidence that an appropriate assessment was made of the costs of meeting the need from internal resources compared with external resources.	5	95
There is a statement of requirements prepared by the department or agency before tendering that is clear about expected performance, timing, services to be provided and estimated cost.	54	46
A departmental contract review committee exists for sole-source contracts, and it reviewed both the need for the requirement and the proposed procurement process.	0	100
The statement of work was approved by an appropriate authority before work began.	86	14

(continued on page 30–16)

Selected Case Studies

These case studies were selected from the sample of 50 contracts that were audited for this chapter. They were selected to provide examples of the different types of problems we observed in contracting practices. They are not intended to be representative of the contracting practices in the departments from which they were drawn.

Problems With Challenges to Advance Contract Award Notices



National Defence

In assessing the qualifications of a challenger, the Department appears to have required a higher standard of proof than required of the chosen supplier.

In 1998, National Defence issued a request for proposals for the services of an information technology professional. It received several responses and judged that none met the requirement; letters to that effect were sent to the bidders. Normally in these circumstances, a department would re-examine its requirements to determine if they were too stringent and, if not, would ask the bidders if they wanted to correct the deficiencies in their

original bids and bid again. If it received positive responses, it would tender the requirement again. Instead, because of perceived time constraints the Department approached one of the bidders and, after determining that it had remedied the deficiency in its bid, offered it a contract on a sole-source basis. An ACAN was posted in July 1998; on 30 July a challenge to the ACAN was filed. The Department reviewed the challenge and concluded that in two areas the challenger lacked the required minimum of four years' experience. The Department notified the challenger that the challenge was not valid, and awarded a contract for \$348,820 to the selected supplier.

Our review of the selected supplier's qualifications led us to conclude that its proposal was deficient in the same two areas as the rejected challenger's. It had provided a statement that the person it proposed to supply met the requirements. However, it appears that the Department did not scrutinize the individual's resume as thoroughly as that furnished by the challenger. Clearly, in a competitive tendering situation all bidders must be assessed in the same way against the same standard. Apparently in this case, a more stringent assessment was applied to the challenger than to the chosen supplier.



National Defence

This case raises the question of the standard a challenge must meet to be considered valid.

On 12 June 1998, the Department posted an ACAN for a \$75,000 contract, indicating that it required a senior person to provide it with advice related, in part, to compensation issues. The ACAN contained a list of required qualifications and identified a supplier as the one uniquely qualified to meet its requirement. On 26 June, the Department received a written challenge from another supplier who indicated that it was capable of doing the task. On 3 July the challenger wrote to the Department again in support of its challenge. Its letter expressed surprise that the Department could not supply it with a statement of work (SOW) for the requirement, and continued as follows:

"... an SOW would be very helpful to us to make sure that we clearly understand the requirement, anticipated deliverables, milestones and related issues. Without an SOW, we must select a CV from our firm, based on less than *nine lines* [emphasis in the original] of text provided in your ACAN. We do not consider this fair, since you have stated that you will decide whether to open this contract to competition, based on the relevance of the CV that we send you."

On 10 July, the Department wrote to the challenger that, in its view, the ACAN contained all of the necessary information and that hence a SOW was not required. It advised of the areas, detailed in the ACAN, in which the resume of the challenger was deficient.

The Department concluded, "Your response did not provide sufficient evidence which demonstrates the capability of your firm fulfilling this requirement."

Based on the material submitted by the chosen supplier and provided to us by the Department, we assessed the supplier's qualifications against those in the ACAN and we were unable to determine whether the supplier fully met the requirements. In our view, it was unreasonable to require the challenger to meet a higher standard of proof than was required of the selected supplier. This raises two questions: What standard of proof must a challenger meet? and What information is a challenger entitled to have in order to prepare a challenge?



Canadian International Development Agency

CIDA did not respond appropriately to a challenge of an ACAN and awarded a sole-source contract to the supplier with whom it had originally intended to contract.

On 30 July 1998, CIDA posted an ACAN announcing its intent to contract with a selected supplier to provide monitoring and evaluation services for agri-forestry projects in Kenya and South Africa. On 9 August, the Agency received a written challenge to the ACAN from a second supplier. The person who reviewed the challenge noted that it appeared to be "a very strong one." The Agency's response was to cancel the ACAN, in a notice posted 13 August. This step was taken correctly. The next steps should have been to communicate in writing to the

challenger (as CIDA committed to do in its ACAN) that it considered the challenge valid, and to open the contract to competition by calling for tenders. The Agency took neither step.

Following the cancellation of the ACAN, the Agency re-examined its requirements and concluded that the work in South Africa could be done by other contractors whom it had already engaged. However, it still required a supplier for the work in Kenya. Rather than opening that requirement to competition, on 5 September the Agency let a sole-source contract for \$29,960 to the supplier it had identified in the original ACAN, in the full knowledge that there was at least one other potential supplier. No ACAN was posted for

the contract. The decision to sole-source a contract for \$29,960 is technically permissible because CIDA has a higher dollar exemption for sole-sourcing.* However, the decision to proceed in this way violated the spirit of the regulations and was an inappropriate response to the intent of the original ACAN and to the valid challenge CIDA had received.

*In the contracting regulations CIDA is permitted to sole-source a contract valued at up to \$100,000 if it is for an international project. However, as a matter of Agency practice this exception is to be invoked only rarely, and it was not invoked in this instance. The remainder of CIDA's operations are subject to the \$25,000 limit that applies to all other departments.

Cases Related to the Use of Contracting for Staffing



National Defence

The Department used contract staff to compensate for apparent delays in the normal staffing process, at substantial additional cost to the government.

In 1998, National Defence let a sole-source contract to a firm of informatics professionals to fulfil a requirement until permanent staff could be hired. The ACAN advertised that the services would be needed for up to six months, at an estimated cost of \$118,000. The contract that was signed covered the 10-month period ending 31 March 1999; it was subsequently amended to change the value to \$177,000 but with no change to the end date. The contract did not specify the rate that the firm was to be paid for the services of the individuals it provided. According to the submitted invoices, the daily rates ranged from \$325 to \$650 — the equivalent of between \$70,000 and \$140,000 per annum. We note that government employees in the Computer Science category at the CS 2 and CS 3 levels

are paid between \$53,000 and \$77,000 per annum (including benefits) for similar work.

The Treasury Board Secretariat's Contracting Policy states:

Contracting for services has traditionally been accepted as an effective way to meet unexpected fluctuations in workload, to acquire special expertise not available in the Public Service, or to fill in for public servants during temporary absences in certain circumstances. At the same time, excessive or improper contracting for services can result in circumvention of person-year controls and government legislation, regulations and policies covering such matters as the merit principle and bilingualism.

According to the Department, this contract was used as an interim staffing measure to

obtain expertise that, while not readily available in the public service, could have been recruited if staffing had been authorized. We were advised that additional staff had been requested at first but that, because of what management claimed were long delays in the Department's internal staffing process, it became necessary to use contract staff to meet ongoing operational requirements. We were provided with neither documentation nor adequate explanations indicating why the possibility of using full-time or term positions was not pursued during this period. Furthermore, we calculate that in this case, the use of a contractor was significantly more costly than staffing.

As with most ACANs in our sample, we found problems with the justification for sole-sourcing. While the Department stated that the firm was the only one capable of meeting the requirement, it could not provide any evidence to support that position.



An unjustified sole-source contract was let in a way that created the appearance of an employer-employee relationship. Further, the payment rate in the contract was set without due regard to economy.

In 1998, CIDA needed financial management services to assist it in an information systems project. On 14 September 1998, it posted an ACAN indicating its intent to acquire the services of the selected contractor for a period of six to eight months. The posting closed on 24 September at 2:00 p.m. and a contract for \$65,000 was let for a period of one year. As the ACAN had been posted for only 10 days, the contract could not be "deemed competitive"; and because it was an internal management project, CIDA's exemption for international projects did not apply. Moreover, the contractor had begun work on 24 September, before the ACAN posting closed.

The initial value of the contract was based on the assumption that the contractor would work

half time over the contract period. However, his time reports indicate that he began working full time from the beginning of the assignment, and the contract funds began to run out with half a year to go. The contract was then amended to \$130,000, to cover the balance of the year. The fact that the contractor began working immediately at double the "planned" rate of effort raises the prospect that this was the equivalent of a split contract. The Agency has no documented explanation for this.

The contract exhibits the characteristics of an employer-employee relationship. The contractor worked on government premises, used government facilities and followed a work plan that was determined by the needs of the government. He worked continuously for longer than 20 weeks, contrary to Treasury Board rules on the use of temporary help.

The contract did not represent due regard to economy. Ultimately, the contractor was paid \$117,500 for a year's work — equivalent to

the salary of a senior executive. The specialist staff at CIDA had recommended that the contractor be paid at the rate of a senior FI-4, which at that time would have been \$359 per day, or \$84,365 for the 235 days of the contract. That would have been close to the cost (including all benefits and payroll taxes) of hiring a senior FI-4 on a term basis for a year. Senior management overrode the recommendation and set the rate at \$500 per day. We have seen no evidence that a term appointment to meet this need was even considered. The decision to contract instead cost the Crown \$33,135.

Finally, the decision to sole-source was not justified; indeed, the documentation we reviewed made no assertion that it was. It simply stated that the contractor met CIDA's requirements and was available.

We have been informed by CIDA that management has examined this case and taken steps to prevent a repetition of these practices.



Industry Canada

The Department used contractors continuously for a number of years to carry out a specific function, creating the appearance of an employer-employee relationship.

In 1995, Industry Canada awarded a competitive contract to a company to provide three to four clerical employees on a full-time basis. This was a continuation of a practice that had been going on for a number of years. Their job was to do routine checks on the integrity of data being input to one of the Department's information systems. The 1995 contract was for one year, with options to renew for two additional one-year periods.

When the contract expired in 1998, the Department decided to award a new contract to the same company, for a maximum of one year. One of the Department's justifications for sole-sourcing was that the company was "uniquely qualified" because of its past experience. Another was that the quality assurance function that the contractor's staff had been working on was to be phased out, probably in less than a year. The Department said it would not be cost-effective to change contractors and train new people for such a short time.

We have two concerns. First, although a new contractor might have had to absorb some

training costs in order to be competitive, this is a matter for the market to decide. It is not a sufficient justification under the Government Contracts Regulations for awarding a sole-source contract. Second, the Department hired full-time contract staff for four years — well over the 20 weeks allowed for temporary help — to do work on government premises, using government equipment, and in accordance with government-established procedures, creating the appearance of an employer-employee relationship. The Department has informed us that the contract ended on 30 September 1999.

Cases Related to the Quality of the ACAN



Human Resources Development Canada

Two sole-source contracts, one retroactive and the other using an ACAN that did not accurately describe the nature of the work, should have been opened to competition.

In October 1998, Human Resources Development Canada (HRDC) awarded a contract to a communications company, retroactive to 1 April 1998. The company had carried out a pilot project to test a system that enabled clients to register electronically for Social Insurance Numbers. On the basis of the pilot, the Department later decided to contract with the company on a sole-source basis to operate the system in one province for 24 months.

The decision to sole-source this second contract was not justified under the contracting rules. Although HRDC has since told us that other communications companies would be capable of operating the system from virtually any call centre, at the time it justified sole-sourcing on the grounds that the company was "uniquely positioned". Clearly, the contractor was not unique, and the contract did not meet the Government Contracts Regulations conditions for sole-sourcing.

We also found that the ACAN posted for this contract did not accurately describe the nature and scope of the work. In effect, it restricted

competition by discouraging other capable suppliers from mounting a challenge. HRDC acknowledges that the statement of work in the ACAN implied that the contract largely involved doing further work on the pilot project as well as related evaluation activities rather than the ongoing operation of the system — which it acknowledges could have been done by other companies. Accordingly, the ACAN did little to further the government's objective of achieving transparent, open and fair contracting.

The Department does not know whether it might have been possible to negotiate more favourable terms through competition.



National Defence and Public Works and Government Services Canada

A sole-source contract was issued that should have been opened to competition, and an ACAN was posted that did not meet requirements.

On 13 August 1998, National Defence sent a requisition to PWGSC to begin the process of setting up a sole-source contract of \$141,220 for a consultant to provide a baseline review of support services at one of its bases. This was to be part of a review of alternative services delivery. The justification for sole-sourcing that was supplied to PWGSC (and subsequently posted in the ACAN) was twofold: the requirement was urgent, as the work had to be completed by mid-December 1998; and the chosen supplier was very knowledgeable and would do a good job. Neither of these reasons is recognized in the regulations as a justification for not opening such a contract to competition. While the deadlines appeared tight when the contracting process began, the selected supplier's initial proposal is dated

16 June 1998 — some two months earlier. These circumstances fall well short of those that warrant invoking the "pressing emergency" exception to the regulations. Moreover, although the Department states that the chosen supplier was well qualified, it did not claim that the supplier was unique.

Notwithstanding the absence of a sole-sourcing justification, the Department and PWGSC posted an ACAN on 8 September 1998 with a closing date of 17 September 1998.

On 17 September, a written challenge was received from a major firm, asking that the requirement be opened to competition:

We feel that based on the criteria used to determine this opportunity as an ACAN, we fully qualify to provide these services . . . We also believe that other firms

possess the qualifications required to provide the services for this ACAN and, based upon the dollar value of the assignment, this should have followed a competitive procurement process.

However, on 18 September, after receiving assurances that this contract represented only the initial part of a larger procurement and that the second part would be competitively tendered, the firm withdrew its challenge.

On 23 September 1998 the contract was awarded to the chosen supplier. National Defence has argued that the withdrawal of the challenge meant there was no "valid" challenge and that it was thus free to proceed. However, the withdrawal of the challenge did not alter the facts that there were other firms qualified to supply the services and that the justifications given for sole-sourcing did not support the posting of an ACAN in the first place.

Cases Related to Sole-Sourcing on the Basis of Prior Experience



Industry Canada

The Department entered into a sole-source contract that created the appearance of contract splitting and other breaches of the contracting rules and that should have been opened to competition.

This contract is one in a series awarded to a company to provide computer-related support to Industry Canada. It was sole-sourced after an ACAN was posted indicating that the contractors had extensive experience and knowledge of the requisite business software, which enabled it to bridge two production environments. As well, it had expertise in

planning and co-ordinating system migration projects for other departments. (We note that other firms had provided the same types of services.)

The evidence appears to indicate that the Department split the contract to avoid NAFTA-related rules. These rules require justification for sole-sourcing contracts of this nature if their value (including GST) is more than \$72,600. We found that the requirement had initially been estimated at \$110,000. When it was brought to the attention of the responsible manager that the value of the

contract would make it subject to NAFTA and the Agreement on Internal Trade (AIT), the requirement was reduced to \$65,000, plus GST — the value stated in the ACAN. This creates the appearance that the reduction was made to avoid the rules under NAFTA and AIT and not because the scope of the required work had changed. During 1999, the Department amended the contract by increasing the scope and duration of the work. At the time of our audit, the value of the contract had been increased to approximately \$177,000 including GST. The contract ended in September 1999.



National Defence and Public Works and Government Services Canada

PWGSC acting on behalf of National Defence issued a sole-source contract that should have been tendered because the uniqueness of the selected supplier had not been established. The case shows the difficulties of negotiating a rate with a supplier once the ACAN has been posted.

In May 1998, PWGSC on behalf of and based on information supplied by National Defence let a sole-source contract of \$128,400 for assistance in restructuring the corporate services function in a headquarters branch. An ACAN was posted for 13 days. The contract required the selected firm to supply the services of a specified individual for a period of six months. Through amendments, the contract was extended to cover an 11-month period; its value was increased to \$176,550.

We found compliance problems with the contract. The Department used the

uniqueness exception to justify sole-sourcing. It stated that there was no other firm with the same current, specialized, comprehensive base of knowledge and experience, but it was unable to provide us with any evidence to support that statement. While the Department's stated justification for sole-sourcing made a strong case for the selected supplier's qualifications, it failed to provide any evidence that there were no other suppliers equally capable. The statement of justification thus falls short of what is needed to demonstrate that the selected supplier is unique. Accordingly, sole-sourcing this contract was not in compliance with the regulations.

PWGSC, the contracting authority, had difficulty establishing a rate for the contractor. It noted that the firm was refusing to negotiate the rate, although under previous contracts with the Department it had been paid a much lower rate than it was asking for in this

contract. Ultimately, National Defence as the technical authority took responsibility for the demanded rate and approved it. This illustrates the potential difficulty of establishing a contract's value without the market test that competition provides, particularly when the selected supplier is aware that management is on the record in the ACAN as considering it the only one capable of meeting the requirement.

In the course of our inquiries we became aware that, to assist management in business transformation work, the Department had established a competitive standing offer with a number of firms, including the selected supplier, all of whom the Department considered capable of performing the general type of work contracted for in this instance. In the standing offer, the rate quoted for a person at the level of the selected individual is approximately \$100 per day lower than the rate ultimately agreed to by the Department.

(continued from page 30–10)

When expectations are unclear, “best value” is at risk.

interviews with departmental managers that their senior management discourages the hiring of new staff; and even when they are permitted to hire, the process is seen as complex, slow and in need of streamlining. Consequently, to meet their program requirements they view contracting as the only feasible alternative “to get the job done”. The absence of a “make or buy” analysis, indicating the relative advantages of both options, increases the risk that managers with the appropriate authority to approve and spend public funds will decide to do so without the benefit of an informed business rationale.

30.30 Our audit also found that in 46 percent of the cases the statement of work and statement of requirements were unclear about expected performance, level of effort, the services to be delivered and the costs. When expectations are unclear, the achievement of “best value” is at risk. Furthermore, when contracting is used to fill gaps in staffing, unclear service expectations can increase the risk that an employer/employee relationship will develop. When this happens, there is a risk to the Crown — allegations of an employer-employee relationship could leave a department open to penalties for unpaid Employment Insurance premiums, Canada Pension Plan contributions and income tax deductions. It could also be subject to claims for benefits, including pensions, and to payments of notice or pay in lieu of notice if the contract were to be cancelled. The Treasury Board Secretariat’s policy clearly cautions departments about the need to avoid establishing such a relationship. Finally, a statement of work that is unclear increases the risk that the department may not receive the service it expected and may become involved in disputes with the contractor.

30.31 The Treasury Board Secretariat’s Contracting Policy encourages departments to establish a mechanism for formal internal review of all proposed

contracts. It recommends a review of all aspects of a proposed contract, including the definition of needs and the justification for sole-sourcing. It also recommends that the results of these reviews be provided regularly to deputy heads so they can determine whether their delegated signing powers are being administered properly. Only one of the four departments in our sample had a formal contract review function, and it had a relatively limited mandate that did not include examining sole-source contracts. Consequently, management has lost, along with the benefits of challenge review, the opportunity to confirm the need for the contract, compliance with the government’s policy, and the legitimacy of the proposed procurement process.

The decision to sole-source

30.32 As we have noted, there are four specific circumstances that allow for an exception to the regulatory requirement to solicit competitive bids when contracting. The Treasury Board Secretariat’s Contracting Policy provides clear guidance to managers who may want to use an exception to justify their decision to sole-source. Over one third of the contracts in our sample were subject to the provisions of one or more of the trade agreements cited in paragraph 30.17. However, in all of these cases the relevant provisions of the Government Contracts Regulations, which apply to all government contracts, are as restrictive or more restrictive than the corresponding trade agreement provisions.

30.33 The Contracting Policy requires that use of an exception be fully justified on the contract file. If the contract qualifies for an exception, the contracting authority is encouraged, whenever possible, to advertise the intent to sole-source through an Advance Contract Award Notice and to justify it in the ACAN.

30.34 The policy places the onus on a manager who believes that an exception

applies to a contract to show clearly why it is warranted. The manager is expected to provide written evidence in the contract file to justify the exception. We expected that the contract files in our sample would clearly identify which exception had been invoked to justify sole-sourcing, and would contain written evidence of management's due diligence in verifying that the exception was warranted.

30.35 Only 11 percent of the 50 contracts we examined had a justification for sole-sourcing on file that complied with the conditions stipulated in the Government Contracts Regulations (see Exhibit 30.3). Specifically, none of the contracts in our sample were for under \$25,000. None invoked the exceptions for pressing emergency or national interest. The critical decision used to justify sole-sourcing most of these contracts was the determination that the contractor was "unique" — that is, the only person or firm capable of performing the work. Managers are supposed to make this determination, justify it and document it *before* deciding to sole-source and *before* posting an ACAN. However, in 89 percent of the 50 cases we examined, the uniqueness of the contractor was either not determined at all (that is, management was fully aware that the firm selected was not unique) or was unsupported in fact.

30.36 Program managers often consider the knowledge and experience gained by a contractor in the course of previous work for them as sufficient to justify a determination that the contractor is unique (see Exhibit 30.4). This is not consistent with current Treasury Board Secretariat guidance and represents an abuse of the program manager's delegated contracting authority. Recent decisions on contracting by the Canadian International Trade Tribunal (CITT) recognize prior experience as one legitimate factor in assessing the qualifications of a potential supplier. However, the CITT decisions also emphasize that the advantage of

incumbency ought not to be used as a reason to avoid competition and that the government must be careful not to overstate the value of incumbency in setting up competitions for contracts. We observed a number of instances in which an incumbency advantage, often gained as the result of earlier, unjustified sole-source contracts, had become the sole basis to justify uniqueness (and further contracts).

30.37 In departments there is usually a division of duties between the "contracting authority" — the specialist group in the department responsible for actually drafting the contract and looking after the legal aspects of the contracting process — and the "technical authority" — the line manager to whom the contractor will actually provide the services. A department that contracts through PWGSC is the technical authority and PWGSC is the contracting authority. Our audit found that, irrespective of location, the role of the contracting authority is too often primarily transactional. In only 25 percent of the cases did we see evidence that the contracting authority had effectively challenged either the substance of the

Only 11 percent of contracts we examined had a justification for sole-sourcing that complied with the Government Contracts Regulations.

Exhibit 30.3

Decision to Use Sole-Source Procurement

Percentage of contracts in our sample of 50 that met or did not meet the Government Contracts Regulations criteria for sole-sourcing.

Criteria	Met	Not Met
The reasons for choosing sole-sourcing rather than competitive tendering were identified and documented.	49	51
The decision to sole-source was in accordance with one of the four exceptions in the regulations.*	11	89
The contracting authority made sufficient inquiries to determine whether the justification for sole-sourcing proposed by the technical authority was substantively valid.	25	75

* When CIDA lets a contract in direct support of an international aid project, it is permitted by the regulations to sole-source for contracts up to \$100,000. However, as a matter of Agency practice, to encourage competition and transparency CIDA invokes this exception rarely and encourages its managers to either tender or use an ACAN for all contracts over \$25,000. This exception was not invoked for any of the contracts in the sample.

The contractor
community is often
denied access to
potential business.

sole-source justifications advanced by the managers or the fact that they did not comply with the regulations. In general, the contracting authorities had restricted this aspect of their role to ensuring that some statement of justification was on the file.

30.38 The result is that the departments far too often bypassed the competitive process improperly and used sole-sourcing, as Exhibit 30.3 also shows. Program managers frequently told us that they chose sole-sourcing over the competitive process because it was a less complex and quicker way to contract. This has an adverse effect on the integrity of the contracting process.

30.39 Accordingly, many more contracts than could be justified were awarded without competition — a situation that does not reflect the principle of open access to contracting opportunities with the federal government. The awarding of these contracts would not withstand public scrutiny. This situation also imposes significant opportunity costs on the contractor community at large, which is all too often unfairly denied

access to potential business that it has a right to compete for.

Setting up the contract to provide for best price and value

30.40 Sole-sourcing for services leaves vulnerable the government's goal of receiving best value. In contrast, when bids are sought, the request for proposals requires a clear statement of the nature and scope of the work and of what specifically is to be delivered. The competitive bidding process thus provides some degree of assurance that the best value will emerge from among the bids submitted. In a non-competitive situation, especially one that lacks these elements and where the chosen supplier is in a near-monopoly position, it is important that other steps be taken to ensure best value.

30.41 One such step is management's preparation of a detailed statement of the work to be done or the results expected and how they will be assessed, along with its estimate of the nature, extent and cost of the work. These form the basis for requesting a proposal from the selected supplier and for assessing its reasonableness.

30.42 It is also important that management ascertain the "prevailing rate" for the services of similarly qualified individuals or firms and use this information in negotiating the rate for the contract. The Treasury Board Secretariat recommends that in sole-source situations, management examine the selected supplier's costs and consider requiring the supplier to certify that it is giving the Crown its best rate. In our view, cost certification should be a routine part of all sole-source contracts. Finally, before work begins, each contract is to clearly set out what is to be done, by when, and at what cost.

30.43 In general, we found in our sample of contracts that the justification for the requirement was often weak, the

Exhibit 30.4

Reasons Given by Program Managers for Sole-Sourcing Contracts in Our Sample

Criteria	Number of Contracts
Prior experience with program or project	34
Best candidate for the requirement	14
Management does not know of another source	2
Not in the public interest**	5
Proprietary rights	3
Unique capability	3
Not cost-effective to change contractors	2
Other	2
Total	65*

* Adds to more than 50 because sometimes more than one reason was given.

** Use of this reason reflects the manager's decision that the chosen supplier would win a competition if it were held and hence, in management's view, it was not in the public interest to give the other suppliers a chance.

statement of work was generally vague and uncotted, and the proposal was not assessed against an independently drafted statement of requirements. Like other sole-source contracts for professional services that we reviewed last year, these contracts were not well managed.

30.44 In 46 percent of the cases, the department had not prepared a fully developed statement of work that included management's estimates of the time and costs involved to do the work. Often we found that the only detailed statement of work, assessment of time and costs, and definition of deliverables had been prepared by the selected contractor in response to the department's very summary statement of requirements. Moreover, in 31 percent of the cases we found that the statement of work in the actual contract differed significantly from the statement of requirements made available to other potential suppliers through the ACAN process.

30.45 We found evidence in only 23 percent of the cases that the amount of work proposed by the contractor had been examined critically. Price support or evidence that fees had been negotiated on the basis of known prevailing rates was provided for 35 percent of the contracts. In 39 percent of the 50 cases, management had obtained the supplier's certification that it was offering its best price. In those cases, at least, some assurance was provided on price — if not on value. Exhibit 30.5 shows our criteria for setting up the contract to provide for the best price and value.

30.46 The departments were not able to provide any other evidence that the government was receiving good value from these contracts. Managers generally asserted that they had undertaken price negotiations, but they were unable to provide us with documented evidence of this. A more disciplined and well-structured approach to negotiations is

needed to demonstrate due diligence and to obtain best value.

Ensuring delivery in accordance with the terms of the contract

30.47 The Treasury Board Secretariat's policy states that the terms and conditions of any contract issued are to be in writing, and that the contract is to be signed by the authorized departmental officials and the contractor's representatives as soon as possible after notice of the award to the successful bidder. Without a written and signed contract that specifies the terms and conditions of the work to be done, it is difficult for the Crown to ensure that it is getting what it intended to purchase and to hold the contractor accountable.

30.48 We examined the contract files for evidence that the contractor had carried out the work in accordance with the contract specifications, on time, and at the agreed cost. Our audit criteria were based on the Government Contracts Regulations and the Treasury Board Secretariat's Contracting Policy.

In only 23 percent of the cases was the amount of work proposed by the contractor examined critically.

Exhibit 30.5

Selection of Supplier, Setting Up the Contract

Percentage of contracts in our sample of 50 that met or did not meet our criteria for setting up the contract to provide for best price and value.

Criteria	Met	Not Met
The contractor's proposal was assessed against the statement of requirements prepared by the department to ensure that mandatory requirements were met, and that the proposal was commensurate with the scope and estimated cost of the work.	23	77
The supplier was required to certify that its prices were as low as those given to its most favoured customer/client.	39	61
The supplier was required to supply financial information about its operations to support its proposed prices.	35	65
The statement of requirements posted in the ACAN and the statement of work in the contract were substantially the same.	69	31
A discretionary audit clause was included in the contract.	98	2
There is evidence that an audit was conducted.	0	100

30.49 We found that the deliverables — the services the contractor was to provide — were generally described in intangible terms (such as “advice” and “professional services”). Most contracts did not specify clearly what service was required and over what time period. In the absence of a clear basis for holding the supplier accountable, the program manager’s ability to effectively manage and administer the contract was compromised from the outset. The potential for achieving best value through sound contract administration practices was placed at risk.

30.50 In just over 50 percent of the cases were departments able to provide us with copies of suppliers’ invoices and sign-offs certifying that the services had been delivered in accordance with the contract conditions and in accordance with section 34 of the *Financial*

Administration Act (see Exhibit 30.6). Other documentation in the files was limited.

30.51 The Treasury Board Secretariat’s Contracting Policy requires departments to document evidence that the deliverables specified in the contract have been provided in full, on time and at the agreed cost. As Exhibit 30.6 also shows, departments could not provide us with that evidence for 56 percent of our sample. Consequently, management is unable to provide assurance that services in those cases were rendered according to all the terms of the contracts and that funds were disbursed for the purposes that had been authorized.

Amendments can compromise open access

30.52 We examined our sample of 50 contract files for evidence that a duly executed contract had been on file when amendments were made, and that the amendments had been properly justified and approved in accordance with Treasury Board policy. We also assessed whether the amendments were in the “best interest of the government” and were neither the result of poor contract planning nor a means of circumventing other contracting rules.

30.53 We found evidence that half the contracts in our sample either continued similar work begun under a previous contract or led to a subsequent contract for similar work.

30.54 Over a third of the contracts in our sample had amendments; only four of these were properly justified and approved. However, it was often difficult to distinguish between the amendment and the original contract’s statement of work and definition of scope, which were ambiguous. The files contained very limited evidence that management had reviewed or challenged either the amount of work provided for in an amendment or the negotiation of the price. The absence of such evidence provides little assurance

Exhibit 30.6

Contract Delivery and Assessment

Percentage of contracts in our sample of 50 that met or did not meet our criteria for ensuring delivery in accordance with the terms of the contract (35 of the contracts did not involve amendments).

Criteria	Met	Not Met
Formal certification pursuant to section 34 of the <i>Financial Administration Act</i> was on file indicating that the services had been delivered as specified in the contract and that payment was justified. (One contract still in progress)	53	46
There was a written assessment of whether the deliverables were provided complete, at acceptable quality, on time and at the contracted price. (One contract still not signed)	43	56
The contract was not a continuation of similar work under a previous contract, and there was no subsequent contract for similar work.	50	50
Contract amendments were properly justified and approved. (64 percent not amended)	31	5
Contract amendments were in the best interest of the government (e.g. not caused by poor contract planning or established with the intent of contract splitting). (64 percent not amended)	27	9

that appropriate efforts were made to obtain best value for the Crown.

30.55 In a quarter of the cases with amendments, we found no indication on file of an increase in the work to be done in return for the increased amount to be paid. Such contract amendments are not in the best interest of the Crown. Poor planning of procurement, inadequate needs analysis and poor definition of requirements contribute to the often complex and expensive process of changing the original contract. Furthermore, extending or substantially amending contracts instead of soliciting new bids compromises both public scrutiny of the spending of public funds and open and fair access to contracting opportunities for other suppliers.

Posting of an Advance Contract Award Notice

30.56 As noted earlier, the posting of an Advance Contract Award Notice (ACAN) indicates a department's intent to award a sole-source contract to a particular supplier. If no other potential suppliers come forward by the end of the posting period, the contract may be awarded to the named supplier. There is no policy requirement about how long an ACAN must be posted. The PWGSC Contracting Manual stipulates that ACANs posted by its officers are to be posted for a minimum of seven working days. The Treasury Board Secretariat's Contracting Policy is unclear on whether there is a minimum period, but officials have told us that the intent is that all ACANs be posted for at least 15 days. What is clear in the Policy, however, is that for the contract to be "deemed competitive" for the purposes of giving a department access to the higher spending authorities that implies, the notice must be posted for at least 15 calendar days. Furthermore, this does not exempt the department from the requirement to confirm, before it posts an ACAN, that the contract qualifies for

sole-sourcing under at least one of the four stipulated exceptions.

30.57 Used properly, ACANs are a useful addition to the government's contracting processes. In particular, they add transparency to the practice of sole-sourcing and, as a consequence, provide the opportunity for challenge by other potential suppliers. Before the use of ACANs was introduced, a sole-source contract remained essentially a private transaction between the chosen supplier and the department until well after the contract was let. The only way an interested party could find out about, let alone object to, such a contact before it was let was "through the grapevine."

30.58 We examined our sample of contracts for their compliance with the Contracting Policy requirements on the use of ACANs. These are outlined in Exhibit 30.7.

ACANs are becoming a "fifth exception"

30.59 As already noted, the Contracting Policy states that before an ACAN is

Used properly, ACANs are a useful addition to the government's contracting processes.

Exhibit 30.7

Posting an ACAN

Percentage of contracts in our sample of 50 that met or did not meet the Treasury Board policy criteria for the use of ACAN.

Criteria	Met	Not Met
The ACAN clearly identified which regulatory exception had been invoked to justify sole-sourcing the requirement, and/or it clearly identified which trade agreement exception had been invoked.	54	46
The posting of the ACAN was in accordance with the policy requirement that one or more of the regulatory exceptions to tendering must apply before an ACAN is posted.	11	89
In accordance with Treasury Board policy, the ACAN gave sufficient information on requirements, services to be provided and products to be delivered, timing and scope of work, and estimated cost to enable a potential supplier to prepare a valid challenge.	42	58
ACAN was posted on MFRX for at least 15 calendar days.	6	94

**ACANs are becoming
an informal “fifth
exception” for
sole-sourcing.**

**Over 90 percent of the
notices in our sample
were posted for less
than 15 days.**

posted, the department must have satisfied itself that one of the exceptions permitting sole-sourcing applies. In particular, the guidance makes it clear that ACANs are not to be used to “test the waters” to see if an exception applies. Our finding that the decision to sole-source was either not justified or not properly substantiated in 89 percent of the 50 cases we examined indicates that the Policy is not being followed.

30.60 In our interviews with managers it became clear that they believed the use of an ACAN significantly lowered the threshold for defining “uniqueness”. Their logic was, in essence, that an ACAN is posted publicly and allows for any other qualified potential supplier to challenge the proposed procurement. If there is no challenge, they reasoned, then there is nobody else who can do the work and the designated supplier is “unique” by default. This widely shared belief is, in our view, establishing ACANs as an informal “fifth exception” for sole-sourcing. The use of this rationale is contrary to both the spirit and the intent of the regulations.

**Statements of requirements often
inadequate**

30.61 It is important that an ACAN contain enough information about the proposed procurement to give a potential supplier an adequate basis to mount a challenge. The necessary information would include, for example, the timing and value of the contract, the specific deliverables and any special requirements a proposal would need to meet, such as security or language requirements. We found that the quality of information contained in posted ACANs is generally incomplete, and sometimes inaccurate. As Exhibit 30.7 shows, for example, in 58 percent of our sample of 50 cases the ACAN failed to provide a sufficiently detailed statement of work and/or requirements, expected results of the procurement, the estimated value of the contract, or the name of the selected

supplier. This is contrary to the intent for ACANs, which is to increase transparency in procurement and encourage challenges. The absence of this information means that other suppliers do not have sufficient information to decide if they can mount a challenge. A vaguely worded ACAN does not stimulate interest among potential suppliers (indeed, it may well mislead them), nor is it likely to result in a challenge. Further, should a potential supplier decide to mount a challenge, a vaguely worded ACAN will leave it at a substantial disadvantage in comparison with the chosen supplier, who may well have had extensive discussions with the department about its requirements. This has an adverse effect on the fairness and integrity of the ACAN process.

No statement of reason for sole-sourcing

30.62 Only 54 percent of the ACANs provided the required statement indicating which of the exceptions was being invoked to justify sole-sourcing. The few in our sample that had to specify reasons for “limited tendering” exceptions under trade agreements did provide complete information, and appeared to have given attention to meeting the policy requirements.

**Not posted long enough to be
“competitive”**

30.63 We found that over 90 percent of the notices in our sample were posted for less than 15 days. Again, this has an adverse effect on openness of access and fairness of opportunity, as potential suppliers may not have enough time to see the posting and mount a credible challenge.

Challenging an ACAN

30.64 In practical terms, the only exception to the competitive tendering requirement that applies to ACANs is the uniqueness of the supplier. If, as required by policy, the departments have taken steps before issuing an ACAN to ensure

that the selected supplier is indeed unique, then there should be no basis for the ACAN to be challenged and challenges should be rare. However, as we have found, departments are not taking the necessary steps and, based on our sample results, we estimate that about 90 percent of the ACANs posted are potentially challengeable.

30.65 This would lead us to expect that ACANs would be challenged relatively often. However, we found that challenges to ACANs are rare (see Exhibit 30.8). Of 522 ACANs for professional services posted by the four departments in 1998, only 35 were formally challenged in writing; 16 of those challenges were subsequently withdrawn by the challenger and the departments dismissed another 10 as invalid. Only 4 challenges were accepted — that is, the department considered whether the original ACAN should be cancelled — and they resulted in the initiation of a competitive procurement.

The management of challenges

30.66 We expected that the management of challenges to ACANs would comply with Treasury Board policy and, in cases involving PWGSC, with its Supply Manual. However, we found in these sources a lack of clear and documented policy direction and guidance for departments. Once an ACAN has been posted, a potential challenger has until the closing date specified in the Notice to present its challenge to the department. A department may reject any challenge received after that date. The guidance to departments on the treatment of challenges is vague. It requires that records of all contacts be kept and that the challenger be informed in writing of the result of the challenge. If the challenge is valid, the department is required to open the contract to competition. However, what constitutes a "valid" challenge is unspecified, as are the challenger's "due process entitlements". Some jurisprudence

on these matters can be found in the decisions issued by the Canadian International Trade Tribunal on awards involving ACANs that were appealed to it, but most managers seem unaware of these decisions.

Lack of due process for challengers

30.67 Our audit findings suggest that there is a significant problem with the fairness of the challenge process.

30.68 There is no consistency in the way challenges are managed, even within a department. Procedures and practices vary with the contract officer and the program manager — in particular, with respect to the burden of proof they require from the challenger. We found no generally accepted criteria that define what constitutes a valid challenge. We also found ambiguity in the respective roles, responsibilities and accountabilities of the contracting officer and the program manager for deciding whether a challenge is valid or not.

30.69 The audit found that the level of effort required of a challenger to demonstrate proof of his or her capability to meet the contract's requirements is much higher than is required of the supplier named in the ACAN. An examination of decisions by the Canadian International Trade Tribunal suggests that it considers the challenger's burden of proof to be lower: the existence of a

We found that challenges to ACANs are rare.

Exhibit 30.8

ACANs Issued and Challenged

Calendar year 1998, issued by the four departments.

Criteria	Number	Percent
ACANs issued	522	100
ACANs challenged in writing	35	7
Challenges withdrawn by challenger	16	3
Challenges dismissed by department	10	2
Challenges accepted by department	4	1
ACAN cancelled by department	5	1

challenge with at least *prima facie* validity should be sufficient reason to put the matter to the test of the marketplace. In the cases we examined, it appears that the departments required the challenger to meet a standard of proof “beyond a reasonable doubt” before they would accept the validity of the challenge and open the contract to competition.

The challenge process lacks independence.

30.70 We found also that the challenge process lacks independence. A challenge is submitted to, and reviewed by, the same managers who presumably have already determined that the selected supplier is unique. Further, there is no mechanism for recourse to an independent third party if a challenger remains unsatisfied with a department’s response to the challenge. An exception is when the contract is subject to one of the national or international trade agreements. In that case, after the initial departmental review, any dispute can then be appealed to the CITT (see Exhibit 30.9).

30.71 As already noted, while most ACANs could be challenged it is relatively rare that they are. A challenge represents an investment by the challenger of not only resources but also, potentially, good will. Very short time frames to formulate a challenge (15 days at most and typically less); an already chosen supplier who may have had months and the assistance of departmental officials to develop its proposal; a statement of requirements that may be vague and incomplete; a decision on the challenge’s validity made by the very people who originally elected to sole-source, judged against unknown criteria to meet an unspecified standard of proof — taken together, these constitute good reasons for a potential challenger to decide that the investment does not hold a reasonable prospect of return.

30.72 In the end, what do ACANs as they are currently used add to the procurement process? It can be fairly concluded that they add transparency to

Exhibit 30.9

Canadian International Trade Tribunal – Sample Case

The Canadian International Trade Tribunal (CITT) is an impartial quasi-judicial body reporting to Parliament through the Minister of Finance. The Tribunal conducts inquiries into complaints by potential suppliers concerning procurements by the federal government that are covered by the *North American Free Trade Agreement*, the *Agreement on Internal Trade* and the *World Trade Organization Agreement on Government Procurement*.

The CITT adjudicated 73 cases from 1 April 1994 to 31 March 1999 including seven sole-source contracts, each of which was advertised by an ACAN. The CITT ruled in favour of the complainant in all seven cases.

In March 1999, Human Resources Development Canada posted an ACAN announcing its intention to contract with Microsoft to purchase certain software. Novell challenged the ACAN in writing. The challenge was not accepted and in April 1999 Novell filed a complaint with the CITT. In its complaint, Novell stated that this purchase was the penultimate step in HRDC’s project aimed at eventually replacing its existing software with a single department-wide implementation of Microsoft’s software. Novell also asserted that despite its protests to HRDC, it had not been provided with the information that it needed to respond to the ACAN and demonstrate its ability to meet the requirement. The CITT concluded that it was not persuaded that there was no reasonable alternative to the chosen software. It further stated that sole-sourcing this contract in the light of overwhelming indications of future long-term needs would seriously prejudice Novell and the competitive procurement system itself. It recommended that the contract be terminated, and that the requirement be drafted in generic terms and opened to competition. It awarded costs to Novell.

This ruling in favour of Novell’s complaint is indicative of how the CITT interprets article 1016(2) of the North American Free Trade Agreement and corresponding articles of the Agreement on Government Procurement and the Agreement on Internal Trade. These articles relate to the fourth exception to the Treasury Board Government Contracts Regulations, which permits sole-sourcing where only one person is capable of performing the work.

the sole-sourcing of contracts, an area that before was relatively opaque. This transparency has led to some challenges by potential suppliers. It is not by accident that all of the sole-sourcing cases heard by the CITT since 1994 had been advertised in an ACAN. At least some of the proposed contracts in our sample were challenged. However, based on our audit findings we conclude that ACANs have contributed very little to competitiveness. Indeed, the fact that many in departments view them as having lessened the stringency of the uniqueness exception suggests that, on balance, their impact may have been a negative one.

ACANs and reporting on contracting performance

30.73 In compiling its statistics on contracting performance for 1996 and 1997, the Treasury Board Secretariat began the practice of treating contracts awarded after posting an ACAN as "competitive" for some statistical reporting purposes. In our view, this practice is misleading. First, as can be seen from our observations, the contracts are sole-source contracts — not the result of an open, competitive tendering process. Posting a notice of the intent to issue a sole-source contract is not a substitute for competition. Second, the classification is in error even by the Secretariat's own definition, as we estimate that approximately 90 percent of the ACANs posted in 1997 were not posted for the 15 days required for them to be "deemed competitive."

Values and the Use of Sole-Sourcing

30.74 Procurement decisions involve the exercise of judgment and discretion. They confer a benefit on the chosen supplier and equally deny the possibility of that benefit to all other potential suppliers. The decision to direct a contract involves more discretion than the decision to choose a supplier through a competitive

bidding process. In directed (sole-source) contracting, there is no comparison of bids. With fewer controls, sound values are essential. Ultimately, probity in contracting depends on the sound values of individuals and a management infrastructure that supports those values.

30.75 In ethical terms, if there were no contracting regulations, a decision to sole-source a contract would require the balancing of different values. On the one hand is the efficiency and often personal convenience that sole-sourcing affords the manager; a qualified supplier is at hand and can begin work quickly, whereas opening the requirement to competition will be time-consuming, add cost, and may well yield the same result. On the other hand is the right of all suppliers to compete fairly for the Crown's business, and the expectation of taxpayers that they will receive the economic benefits of the competitive market. Fortunately, in this instance, individual managers do not have to determine where that balance of values lies; it has been determined for them by the government and is reflected in the contracting regulations. In those regulations, the government has, with narrowly drawn exceptions, established the balance firmly in favour of the rights of suppliers to compete fairly for business. Expanding on the exceptions, or ignoring them, represents an unwarranted decision by individual officials to alter the value balance that the government has established to guide the conduct of its affairs.

30.76 Our 1995 Report included a chapter on a study of ethics and fraud awareness in government. In the study, we asked public servants and senior managers if they believed it would be appropriate to issue a sole-source contract for \$50,000 when instructed to do so by a superior if they knew that more than one supplier could provide the goods or services. Seventy-one percent of senior managers and 78 percent of public servants believed that it would be inappropriate.

Expanding on the permitted exceptions, or ignoring them, represents an unwarranted decision by individual officials to alter the balance of values the government has established to guide the conduct of its affairs.

The continuing practice of trying to justify the uniqueness of that which is clearly not unique can only have a morally corrosive effect on the working ethics of all of those involved in it.

30.77 Part of ensuring that contracting remains an “ethical” process is ensuring that staff at all levels follow the government’s contracting rules and regulations. It is important to document the rationale for any contracting decision; documentation is particularly important when a sole-source contract is contemplated. A written record of decisions leading to the awarding of a contract is key to demonstrating that there is a need to contract, that requirements have been thought out carefully, and that the “right” contractor has been chosen. Later, it is important to document whether the contractor has delivered a good product on time and at reasonable cost. All of this information is needed so that managers can be held accountable for the contracting decisions they make.

30.78 The evidence we obtained in this audit suggests that in many instances, contracts were sole-sourced with full knowledge that the chosen supplier was not unique and that no other exception applied. In some cases, incomplete, incorrect and misleading information was provided in the ACAN. We are concerned that such practices deprive other potential suppliers of the rightful opportunity to bid. Further, the continuing practice of trying to justify the uniqueness of that which is clearly not unique can only have a morally corrosive effect on the working ethics of all of those involved in it.

Conclusion and Recommendations

30.79 This year, we examined 50 sole-source contracts that were advertised using an ACAN. We found that 89 percent of the contracts we reviewed should, under the government’s rules, have been put out to public tender.

30.80 The decision to sole-source was, in our opinion, in accordance with the regulations in only 11 percent of the cases examined. In last year’s audit we found

that nearly a third of the sole-sourcing decisions were justified. Some of this difference may be explained by the fact that all of this year’s contracts were advertised using ACANs, combined with the view generally held by the managers we interviewed that posting an ACAN reduces the onus on them to first fully establish the uniqueness of their chosen supplier. This leads to a conclusion that for most of the public servants associated with these contracts, the ACAN has become an unofficial “fifth exception” to the requirement that contracts be competitively tendered.

30.81 While there is no doubt that ACANs do increase the transparency of sole-source contracting, they do little to increase competitiveness. In addition to the problems associated with the uniqueness exception are the problems related to the completeness and accuracy of the ACANs, the absence of a clearly stated and widely shared standard of proof required for challenges, and the lack of guidance on standards of due process for challengers. These need to be addressed before ACANs begin to play a role beyond adding transparency.

The sole-source syndrome

30.82 The combined results of this year’s and last year’s audits lead to a conclusion that contract management problems — inadequate needs assessment, poor definition of requirements, weak cost control and poor control over deliverables — represent a syndrome arising from the lack of challenge and discipline inherent in the sole-sourcing process. The competitive tendering process has a certain built-in discipline that encourages good contract management. At the outset, for example, there is a need to develop a statement of requirements that is articulated clearly enough to serve as the basis for a competitive bid solicitation. A scoring system is also developed that permits the bids received to be assessed fairly and objectively. This adds further structure to the contracting process. The

competitive process itself serves to provide some assurance on price and value. The discipline inherent in the process will not guarantee that deliverables will be properly assessed and value received. However, the development of a biddable statement of work and criteria for evaluating bids certainly provides a solid foundation for those activities.

30.83 Based on our work this year and last, it is clear that the problems we have observed are government-wide in nature. While we recognize the Treasury Board Secretariat's limitations in dealing with matters of departmental management, we believe that as the entity responsible for contracting policy its strategic leadership is needed in responding, with departments and agencies, to the problems associated with sole-sourcing and ACANs. Accordingly, we are directing our recommendations to the Treasury Board Secretariat and through it to the departments and agencies of the government as a whole, rather than to any specific entity or entities.

30.84 Last year we concluded that the rules governing contracting were fundamentally sound; the key was to ensure that they were understood and followed. This led to two recommendations; we repeat the essence of those recommendations here.

30.85 **The Treasury Board Secretariat should encourage deputy heads to ensure that those to whom contracting responsibilities are delegated fully understand the dual objectives of government contracting policy (open access and best value) and are held accountable for adherence to them.**

30.86 **The Treasury Board Secretariat should encourage deputy heads to ensure that when contracts are sole-sourced, the circumstances are fully consistent with the provisions of the Government Contracts Regulations and,**

if applicable, the relevant trade agreements.

Treasury Board Secretariat's response:
The Treasury Board's procurement policies, which apply to all departments and agencies, are based on the strong values and principles of competition, openness, equal access, transparency, fairness and best value for Canadians. Treasury Board's role is to establish these policies. Departments are accountable to their ministers and to parliamentarians for implementing these policies. To assure sound implementation, the Treasury Board has committed to developing a program of training and certification for procurement specialists in departments.

30.87 In order for senior management to be accountable for contracting practices, it must be aware of what is happening. We observed that the decisions on sole-sourcing are often made by relatively junior officers and are not subject to review. In particular, we believe that a decision to sole-source on the basis of the supplier's uniqueness needs to be subject to independent review and approval by a senior member of departmental management before an ACAN is posted. We have been informed that National Defence is in the process of forming a senior-level committee whose mandate will include advance reviews when it is deemed necessary. Further, to support departmental senior management in its collective accountability for good contracting practices, we believe that in departments with a high volume of sole-sourcing (annually more than 50 sole-source contracts for amounts over \$25,000), an internal audit of a sample of sole-source contracts needs to be conducted each year to verify compliance with government regulations and departmental policy, and the results reported to the deputy head.

30.88 **The Treasury Board Secretariat should amend its policy on contracting to require that when a decision to sole-source is based on a determination**

ACANs do little to increase competitiveness.

The rules governing contracting are fundamentally sound.

that the selected supplier is unique, the decision must be reviewed and approved by an independent senior departmental manager.

Treasury Board Secretariat's response:
The Treasury Board Contracting Policy already encourages departments and agencies to establish contract review mechanisms to review all, including sole-source, contract proposals. We do not agree that a policy requirement is necessary.

30.89 The Treasury Board Secretariat should encourage deputy heads in departments that let more than 50 sole-source contracts each year for amounts over \$25,000 to require that an annual internal audit of a sample of sole-source contracts be conducted to assess compliance with government regulations and departmental policy. The results of the audits should be reported to the deputy heads.

Treasury Board Secretariat's response:
The Treasury Board Secretariat is committed to implementing a monitoring framework for evaluating contracting activities. Such a framework will rely primarily on the results of departmental internal audits. The Treasury Board Secretariat is committed to consulting with the Auditor General on the best methodology for conducting these internal audits, and will communicate the methodology to departmental internal audit groups. We submit, however, that large-scale auditing of a sample of sole-source contracts by departments that award more than 50 contracts each year for amounts over \$25,000 is simply not a cost-effective use of scarce resources for oversight activities.

30.90 In looking at the instances in which an ACAN has been challenged, we have been struck by the lack of guidance to departments on how this process is to be conducted.

30.91 The Treasury Board Secretariat should develop and publish policy guidance on the management of the challenge process for Advance Contract Award Notices. This guidance should address the issue of the due process rights of challengers and the standard of proof required to sustain the validity of a challenge.

Treasury Board Secretariat's response:
As a follow-up to the guidance on Advance Contract Award Notices issued in March 1999, the Treasury Board has committed to providing further guidance on the implementation of the Advance Contract Notice Policy.

30.92 When a contract for goods or services falls within the ambit of one or more of the trade agreements, an unsatisfied supplier can appeal to the Canadian International Trade Tribunal (CITT) for independent review and resolution of the matter. However, the trade agreements apply only to relatively large contracts for services (over \$72,600 for NAFTA, over \$100,000 for AIT and over \$254,100 for WTO; different threshold values apply to contracts involving goods), and an appeal to the CITT sometimes involves retaining legal counsel and incurring the related expense. For all other contracts, the potential supplier's only recourse is to appeal back to the very department whose actions are the object of the appeal. The availability of an independent and efficient dispute resolution mechanism for appeals in the case of these other contracts could do much to enhance the fairness and transparency of the contracting process in general and sole-sourcing in particular.

30.93 The government should consider establishing an independent dispute resolution mechanism to deal with disputes related to contracts that fall outside the ambit of the trade agreements related to procurement.

Treasury Board Secretariat's response:
The government has in place the

Canadian International Trade Tribunal, which handles bid disputes in contracts subject to three trade agreements, covering the key areas of federal government procurement. In addition, contractors who may have reservations about a contract situation now have recourse to departmental officials to resolve disputes. The Treasury Board Contracting Policy also encourages mediation, negotiation, and arbitration for dispute settlement. Finally, all contractors have the option of using the courts for redress. It is for these reasons that we do not feel an additional dispute mechanism is required.

National Defence's comment: *In the calendar year to date, 18 percent of sole*

source ACAN requests in the Department of National Defence have been denied by the departmental contracting authority. Moreover, the percentage of contracts over \$25,000 involving ACANs has declined from 34 percent to 19 percent over the last three years.

The Department acknowledges the need for continuing improvements in the use of ACANs and has taken steps to increase vigilance over their use. For example, the Department is creating a Contracting Advisory Committee of senior managers to review selected sole-source justifications, analyze trends and advise concerned managers on the need for changes to procedures and delegation levels.

Another Contracting Observation

The following case is one that came to our attention during the course of other audit work done by the Office. It was not one of the sample of cases audited for this chapter. However, many of our concerns about this case echo concerns raised in the chapter and, accordingly, we decided to publish it as part of this chapter rather than in the Other Audit Observations chapter of the Report.

The Royal Canadian Mounted Police and Public Works and Government Services Canada

*Assistant Auditor General: Jean Ste-Marie
Director: Peter Sorby*

The RCMP gave preferential treatment to a contractor and recommended without justification that the contractor receive a sole-source contract for police training. Furthermore, we are concerned about the conclusions drawn from an internal RCMP administrative review and a PWGSC review of the contracting process.

In 1996 the Royal Canadian Mounted Police recommended that Public Works and Government Services Canada (PWGSC) award a \$362,000 sole-source contract for police training services. The contract did not meet the criteria for sole-sourcing specified in the Government Contracts Regulations. With additional competitively awarded contracts, the company has received a total of about \$913,000.

30.94 In March 1996, a foreign government requested training assistance for its police supervisors. The RCMP decided it would hire a contractor to develop a course curriculum and train RCMP instructors, who would then train the foreign country's local police instructors. The contractor also would monitor the RCMP's training of the local instructors.

30.95 In June 1996, the RCMP initiated discussions with a single supplier to

provide these services. The next month, it requested that PWGSC award a sole-source contract to this supplier. The RCMP's justification for sole-sourcing was that the work was urgent and confidential and that the firm had unique knowledge or experience. Normally, if the "pressing emergency" exception is invoked, the contract is let immediately to reflect the urgency of the requirement. However, more than four months elapsed between the foreign government's request for the assistance and the RCMP's request that PWGSC initiate the contracting process.

30.96 The RCMP had provided its selected supplier, the prime contractor, with information about the contract requirements one month before initiating the contracting process with PWGSC. It had met with the supplier to discuss the training program before the contracting process began and had informed him that no other suppliers were being considered for the job. Based on that information, and with documentation that the RCMP provided on the new training model to be used, the supplier began working on the project two months before PWGSC awarded the contract. Further, the supplier travelled to the foreign country to prepare and begin the training program before the contract was awarded.

30.97 In late August 1996, PWGSC awarded the contract on a sole-source basis because “the nature of the work was such that it would not be in the public interest to solicit bids.” PWGSC told us this reflected RCMP representations that a public tender of the contract could embarrass both the Canadian and the foreign governments. Furthermore, PWGSC did not post an ACAN because the RCMP indicated that the contract involved work that was confidential, and the requirement to post an ACAN can be waived in such circumstances.

30.98 The RCMP’s justification that it would not be in the public interest to solicit bids is not supported. Our examination of public records, including media articles and Hansard transcripts of proceedings in the House of Commons, showed that the state of the foreign police force and the RCMP’s involvement in the training were already matters of public knowledge six months before the RCMP initiated the contracting process. Our review of the contract files revealed that PWGSC concluded there was “no security requirement that applies to this procurement since it does not involve the release of sensitive Canadian information, nor any access to a restricted Canadian site.” In July 1996, the RCMP had signed a security requirement checklist confirming this. It could not provide us with a satisfactory explanation of the contradiction between these statements and its representation to PWGSC that the work to be done was confidential.

30.99 The value of the 1996 contract award, approximately \$362,000, was significantly over the limit of \$25,000 for non-competitive contracts, as prescribed in the Government Contracts Regulations. The contractor was paid \$186,000 for six months work, with the remainder paid to his employees and spent on other related expenses.

30.100 The Government Contracts Regulations state that an exception to

competitive bidding should not be invoked “simply because a proposed contractor is the only one known to management.” The RCMP informed PWGSC that the supplier was the only firm known to have the necessary knowledge and experience. The RCMP did not try to identify other potential firms. An RCMP administrative review indicated that the supplier had been told that no other companies were being considered. The supplier was a former RCMP member and a former co-worker of the RCMP officials involved in initiating this contract.

30.101 In February 1997, senior RCMP officials were requested to approve a second contract with the same supplier in the amount of \$22,500, with contracts of similar size to follow. RCMP documents indicate that the contractor had been told he would be awarded these contracts. Following an external complaint, this request was turned down; RCMP officials concluded that the “awarding of the second contract could have violated Treasury Board guidelines regarding contract splitting.” In May 1997, PWGSC solicited bids from firms for the new contract. The supplier who had been awarded the first contract on a sole-source basis was in an advantageous position and subsequently was awarded the second contract valued at \$315,159.

30.102 The conclusions drawn by previous internal departmental reviews of this contract differ from ours. A PWGSC review that considered only its role in the process concluded, “It is evident that the contracting officer made reasonable efforts to validate the sole-source rationale, and that proper procurement procedures were followed in this regard.” The RCMP’s administrative review concluded that “proper administrative procedures were generally followed during the awarding of the first contract.” We are concerned that neither review detected any significant weaknesses in the contracting practices involved in this contract.



About the Audit

Objective

The objective of this audit was to examine a sample of sole-source professional services contracts to determine the extent to which they complied with the rules for contracting. We chose the contracts from four departments. All of these contracts had been advertised using an Advance Contract Award Notice. The audit assessed the extent to which the four principles that guide federal procurement — openness of access, competition, fairness of opportunity and obtaining best value for the Crown — were achieved by compliance with the rules and good practices for contracting. The overall purpose was to report to Parliament on the results of this work, especially since the ACAN is a relatively new mechanism whose use in government contracting is growing.

Scope

We based our examination on the policy requirements related to directed (sole-source) procurement and the use of ACANs as outlined in both the Government Contracts Regulations (GCRs) and the Treasury Board Manual on Contracting. Our criteria were derived from:

- an analysis of sections 5 and 6 of the GCRs and their interpretation in the Treasury Board policy;
- recent testimony and proceedings of the Public Accounts Committee, and its Report on Contracting for Professional Services;
- interviews with officials in the Treasury Board Secretariat, Public Works and Government Services Canada, and four line departments; and
- previous chapters on contracting in Reports of the Auditor General of Canada — 1997, Chapter 6 and 1998, Chapter 26.

To examine the results achieved by those working within the procurement policy framework, we also considered additional information based on:

- analysis of documents provided by, and discussions held with, officials in National Defence, Industry Canada, Human Resources Development Canada, and the Canadian International Development Agency;
- a survey of all 522 ACANs posted by the four departments in 1998, and certain basic information on all of the Notices and in particular on the nature and disposition of any challenges to them. This included attempting to interview all of the challengers of these contracts (response rate was 80 percent);
- an audit of a sample of more than 50 professional services contracts, selected at random from the 522 that used ACANs and representing payments by the four departments that totalled approximately \$100 million.

The audit sample was identified and selected from the total population on the basis of a computer-generated random sampling frame. The results were adjusted to reflect the sampling design. The 95 percent confidence interval for the percentages presented in the chapter ranges from ± 13 percent for percentages of around 50 percent to ± 8 percent for percentages of around 90 percent.

The audit did not assess either the performance or the qualifications of the suppliers. No comments in the report should be construed as criticism of any supplier.

Related Information Sources

The Standing Committee on Public Accounts, *Report 28, Contracting for Professional Services: Selected Sole-Source Contracts*.

<http://www.parl.gc.ca/InfoComDoc/36/1/PACC/Studies/Reports/paccrp28-e.htm>

The Treasury Board Secretariat, *Contracting Policy*,

http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/Contracting/contractingpol_e.html

Public Works and Government Services Canada, *The Supply Manual*,

<http://www.pwgsc.gc.ca/sos/text/sm/en/>

Audit Team

Assistant Auditor General: Shahid Minto

Principal: Hugh McRoberts

Director: Jaak Vanker

Bryan DePape

Paul Morse

Sami Sourani

Shahid Maqsood

Rosemary Marenger

For information, please contact Hugh McRoberts.

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Chapter 31
Department of Foreign Affairs and International Trade –
Delivery of Capital Projects in Four Missions

November 1999

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 31
Department of Foreign Affairs and International Trade –
Delivery of Capital Projects in Four Missions

November 1999

This November 1999 Report comprises 14 chapters, including “Matters of Special Importance”, as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients’ needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 31

**Department of Foreign Affairs and
International Trade**

**Delivery of Capital Projects
in Four Missions**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Department of Foreign Affairs and International Trade

Delivery of Capital Projects in Four Missions

Main Points

31.1 This audit examined how the Department of Foreign Affairs and International Trade planned and implemented six capital projects at four missions in Seoul, New Delhi, Geneva and Bangkok. Capital costs for these missions totalled about \$75 million, representing approximately 20 percent of the capital expenditures planned by the Department over the five-year life of its Long-Term Capital Plan.

31.2 Delivering capital projects outside of Canada entails significant additional risks, difficulties and challenges not experienced in the delivery of capital projects domestically.

31.3 The audit confirmed that valid reasons existed for initiating each of the projects and that users are generally satisfied with their new accommodation. Overall, the projects were delivered within budgets and project schedules. In general, contracts were awarded on a competitive basis and change orders were well managed. We noted several positive initiatives to address environmental concerns.

31.4 However, we identified weaknesses in the preliminary planning of the projects. Indicative project estimates were incomplete and unreliable. The preliminary cost estimates of three projects increased by \$38 million, representing increases ranging from 64 percent to 153 percent over their initial estimates. In one case, a poor cost estimate may have resulted in an uneconomical expenditure of \$15 million. We estimate that, over the last five years, the opportunity cost of this payment totals \$8 million.

31.5 We are also concerned with the lack of rigour of the Department's analysis of options in support of their recommendations to the Treasury Board. We found instances where the Department failed to document the results of its analysis of various options that may have realized savings totalling at least \$7 million over a 20-year period. We also noted weaknesses in the methodology used by the Department to support its investment decisions, and the lack of documentation to support a particular option.

31.6 The quality of reporting to the Treasury Board to explain project delays and budget increases needs to be improved.

31.7 In summary, the magnitude and frequency of increases in preliminary cost estimates and other problems identified by the audit seem to indicate that systemic weaknesses exist in the Department's planning of capital projects and these need to be addressed.

Background and other observations

31.8 The Department of Foreign Affairs and International Trade manages a significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries. The estimated value of these Crown-owned properties abroad is \$1.5 billion to \$2 billion and annual leasing and capital expenditures total approximately \$110 million and \$60 million respectively. The Department and other government departments use the facilities to deliver their programs.

31.9 This audit reaffirmed our opinion that the government's administrative policies for managing capital projects are sound, but problems persist in their application.

The Department of Foreign Affairs and International Trade agrees with the chapter's recommendations and has developed an action plan that addresses our concerns.

Introduction

31.10 Acquisition, management and disposal of capital assets by all government departments amounts to more than \$10 billion annually. Capital assets include, but are not limited to, land, buildings, works, inventory and equipment. Departments require them for the fulfilment of their mandates and delivery of their operational programs.

31.11 Our review of the government's Part III Estimates for 1997–98 identified planned expenditures of more than \$32 billion over the time required to complete 159 projects, each costing \$10 million or more. The magnitude of these numbers indicates the importance of sound management of this aspect of government operations. Improvements in the planning, design, acquisition, and operating and maintenance of capital projects over their life cycle can result in significant savings to the government.

Audit strategy for capital projects across government departments

31.12 Our Office audits capital projects on a selective basis, taking into account cost, risk and sensitivity. Recent audits include the Parliamentary Precinct Restoration and Renovation Program, the Federal Laboratories for Human and Animal Health Building Project and buying of major capital equipment by National Defence. These and previous audits identified a range of deficiencies in the approval and management practices that resulted in project delays, increased costs and lack of value for money. We continue to audit capital projects on a selective basis across government departments.

Responsibility for capital projects in the Department of Foreign Affairs and International Trade

31.13 The Department of Foreign Affairs and International Trade manages a

significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries. The Department estimates that the value of these Crown-owned properties abroad is about \$1.5 billion to \$2 billion and annual leasing and capital expenditures total approximately \$110 million and \$60 million respectively.

31.14 Within the Department, responsibility and decisions relative to major capital expenditures are shared among the Department's Executive Committee, Physical Resources Bureau (the Bureau), the Geographic Branches and the missions.

31.15 The Bureau is responsible for strategic property planning, analysis and reporting to senior management and the Treasury Board, as appropriate; the implementation and delivery of major capital projects; and the provision of technical services to support the operation and maintenance of facilities abroad. It manages the Long-Term Capital Program, the acquisition (purchase or lease) and construction of chanceries and official residences, the purchase or construction of staff quarters, and major renovation and maintenance projects.

31.16 The Geographic Branches identify property needs, provide assistance and input to the Bureau in prioritizing those needs, and allocate the necessary resources to the missions for the day-to-day operation and maintenance of property abroad, including funding for leasing costs.

31.17 Missions are responsible for the leasing of staff quarters, for landlord-tenant relationships in leased chanceries or official residences, for the day-to-day operation and management of all property in their inventory and for minor maintenance projects. Missions also play an important role in identifying their property needs and assist the Bureau by providing information about local property markets. Other government

The Department of Foreign Affairs and International Trade manages a significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries.

We examined six projects which are being delivered by the Department of Foreign Affairs and International Trade in four missions.

departments identify their property needs abroad and work with the Bureau to fulfil those needs.

Focus of the audit

31.18 We examined six projects, described in Exhibit 31.1, which are being delivered by the Department of Foreign Affairs and International Trade in four missions. These projects have capital

expenditures totalling about \$75 million, representing approximately 20 percent of the capital expenditures planned by the Department over the five-year life of its Long-Term Capital Plan. They comprise a mix of chanceries, staff quarters and an official residence. In selecting the projects, we took into account the project's cost, sensitivity, location (developed and developing countries),

Exhibit 31.1

Projects Selected for Audit



Planned \$55.2 million office and residential complex in Seoul, South Korea

economic crisis. At the time that the construction contract was cancelled, the estimated cost of the project had increased to \$55.2 million, with a revised completion date of summer/fall of 2001. To date, approximately \$17.2 million has been spent on acquisition of the site, design development, costs for contract termination and project management, including travel.



\$25.8 million addition to the existing chancery in New Delhi, India

1993, with completion in September 1996. The project was delivered on budget and approximately five months behind schedule.



18 new staff quarters costing \$9.1 million in New Delhi, India

1. In December 1994, the Department purchased a site in Seoul's Central Business District for approximately \$15 million. During preliminary planning, the project envisaged the design and construction of office and residential accommodation, with a combined gross area of approximately 6,600 square metres at an estimated cost of \$33.6 million, including land. The project was to be completed by December 1997. The Department recently informed us that it has terminated the construction contract and is reassessing its accommodation requirements and options in Seoul due to the increasing availability and lower cost of leased space following the Asian

type (lease, fit-up, construction), and status (work-in-process versus completed). We examined the major aspects of the projects from the perspective of generally accepted practices of good project planning and implementation.

31.19 Our interest in departmental program issues was limited to obtaining a

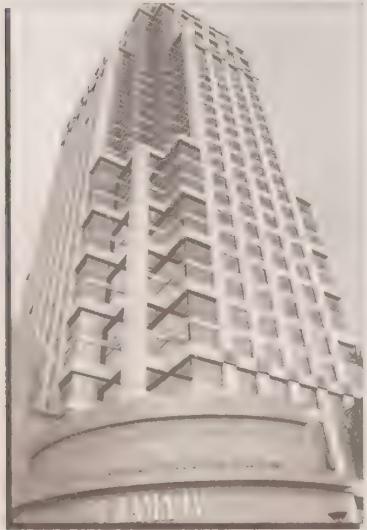
general understanding of the program requirements that the new facilities were designed to meet. Except for their role in the projects examined, we did not audit the Physical Resources Bureau, the Geographic Branches or the missions. Further details on the audit are found at the end of the chapter in **About the Audit**.



\$1.5 million reconstruction of the official residence in New Delhi, India



\$20.0 million new Canadian chancery in Geneva, Switzerland



\$3.2 million fit-up of the chancery in a new leased building in Bangkok, Thailand

Exhibit 31.1 (cont'd)

4. The New Delhi official residence project comprised a major reconstruction of the 65-year-old residence to replace various building components and systems, notably the roof, plumbing, air conditioning and electrical systems. The project was approved in June 1996 at an estimated cost of \$1.3 million and with a completion date of June 1997. The total cost of the project was \$1.5 million and it was delivered on schedule.

5. On 21 March 1996, the Treasury Board approved the purchase of land for the design and construction of a 2,200 net square metre chancery in Geneva, Switzerland at a total estimated cost of \$21.4 million. It was anticipated that the project would be completed by 1 April 1998. As at 29 September 1999, the building was substantially completed at a cost of \$19.5 million. The remaining cost to complete the project is estimated at \$500,000.

6. On November 1996, the Treasury Board approved a three-year lease with two three-year extension options, for approximately 1,980 square metres in a new Class A building, at an average annual rent of Baht 13,300,000 (C \$720,000). The Board also approved \$2.9 million for chancery fit-up and moving costs. The fit-up project was completed approximately two months behind schedule at a cost of \$3.2 million.

Observations and Recommendations

We identified variances between preliminary cost estimates and final project budgets, as well as other problems related to scheduling and project planning.

Risks and challenges in delivering projects abroad

31.20 Although we believe it is important that capital projects meet performance, cost and schedule objectives, we recognize that chanceries and official residences are used to promote Canadian presence and image abroad, which may result in higher costs. We also recognize that there are significant additional risks and challenges in delivering projects outside Canada. For example, the work must adhere to a wide variety of local building, health and safety, fire and environmental codes and comply with all applicable Canadian laws and regulations. Language and cultural differences also add to the complexity of doing business abroad.

31.21 The Department also has an obligation to provide Canadian based staff with living conditions similar to those in Canada, with respect to quality of accommodation. This is particularly important at posts where measures of isolation, location conditions, climate, health, medical care, hostility and violence exist. The Department has developed a “hardship level” one to five rating (five representing the greatest hardship) that is intended to recognize the existence of undesirable conditions at the various posts and to reinforce the importance of providing appropriate accommodation that meets Canadian standards. The hardship levels for the missions that we examined are:

- Bangkok, Thailand — Level III
- Geneva, Switzerland — N/A
- New Delhi, India — Level IV
- Seoul, South Korea — Level III

Government administrative policies for managing capital projects are sound, but problems persist in their application

31.22 Based on previous audits of capital projects, the Auditor General informed the Standing Committee on Public Accounts, on 4 June 1998, that the Treasury Board’s administrative policies for managing capital projects across the government are fundamentally sound and consistent with an environment of increased delegation of responsibilities to departments. We noted that during the past several years, the Treasury Board approved several significant reforms to allow the Department of Foreign Affairs and International Trade to operate in a more businesslike manner. For example, subject to the consideration and approval of an annual Business Plan by the Treasury Board, the Physical Resources Bureau was granted authority to spend in future years the sales proceeds generated by the disposal of properties in any current year in return for reduced dependence on appropriations. Moreover, various contracting authorities were also increased, with a view to making project approvals more efficient.

31.23 Although the government’s policies and guidelines on capital projects are sound, problems continue to persist in their application. We noted that the Bureau has undertaken a number of initiatives to improve the planning, management and delivery of capital projects by the Department; however, we identified variances between preliminary cost estimates and final project budgets, as well as other problems related to scheduling and project planning. These indicate that opportunities for improvement exist and that management needs to continue to focus on this aspect of the property program. We also noted that the Inspector General’s audit of three other capital projects identified similar concerns with project planning. Accordingly, we believe that management needs to address the concerns raised by

both audits. We also encourage the Inspector General's Office to continue to give priority to this aspect of the Department's operations.

Planning

The projects were justified and users are generally satisfied

31.24 The audit confirmed that valid reasons existed for initiating each of the projects and users are generally satisfied with the results. In the case of New Delhi, the need to expand the existing chancery dates back to 1982 when the immigration programs began to increase significantly. Additional staff quarters were constructed to replace some of the older staff quarters and in response to concerns among the diplomatic community in New Delhi about the deteriorating quality of rental accommodations. The already expensive rental costs that were anticipated to continue to rise over the next few years (projections of up to 150 percent) were also a concern among the diplomatic community. The official residence is located in a historical and architecturally significant section of New Delhi. It is a 65-year-old building that required major reconstruction.

31.25 In Bangkok, the purpose of the relocation was to reduce the amount of space and to upgrade the quality of accommodation as the Mission had occupied the facility for over 20 years. We confirmed that the previous premises were old and were scheduled to have been torn down and redeveloped. The Ambassador reported that staff are very satisfied with their new work environment and morale has improved. The staff we spoke to confirmed these views.

31.26 The rented premises in Geneva were one of the Department's most expensive leases. We found that the Department acted appropriately in taking advantage of an economically viable opportunity to secure a long-term

Crown-owned solution for its accommodation requirements. Mission management told us that the new facility will enable them to deliver their programs more effectively and to better accommodate the large number of government officials who conduct business in Geneva.

31.27 The need to seek alternative accommodation in Seoul, South Korea was in response to the landlord's request to vacate the premises in order to carry out needed renovations to the building, and to secure a long-term Crown-owned solution for the Department's accommodation requirements. The Mission and Geographic Branch initially approved the proposed project, consisting of one tower of office space and one tower for residential accommodation. However, current Mission staff have since expressed concern with the proposed project to combine office and residential accommodation in the same building complex. During our field trip, management and staff at the Mission reconfirmed the need to relocate and expressed a high level of dissatisfaction with their current office accommodation. They supported pursuing options to secure new alternative accommodation as soon as possible.

Preliminary project estimates were incomplete and unreliable

31.28 Treasury Board policy on capital projects states that cost estimates must have a sufficiently high degree of quality and reliability to support Treasury Board's consideration of the project or specific phase of the project. For greater clarity, the Treasury Board requires that estimates be prepared as indicative and substantive, as described in Exhibit 31.2.

31.29 Exhibit 31.3 illustrates that the preliminary budgets of three of the six projects examined experienced increases, totalling \$38 million and ranging from 64 percent to 153 percent over their initial estimates, due to changes

The preliminary budgets of three of the six projects examined increased by \$38 million, representing increases ranging from 64 percent to 153 percent over their initial estimates.

in the projects' scope and to poor cost estimation. As a result, management and the Treasury Board did not have a reliable estimate of the project's cost prior to granting preliminary approval. The case study on page 31–13 provides an example of how a poor cost estimate was used to support an uneconomical investment option that may have led to an unproductive \$15 million expenditure.

31.30 In the case of the New Delhi chancery, the Department informed the

Treasury Board that the additional costs were necessary to correct deficiencies in the existing facilities. The costs were mainly due to upgrades to the mechanical systems in the existing building as a result of on-site inspections, to improvements in the recreational facilities, and to other unplanned costs for travel and on-site management. We believe that most of these costs could have reasonably been identified prior to seeking preliminary project approval.

Exhibit 31.2

Indicative and Substantive Cost Estimates

An “indicative estimate” provides a rough cost projection used for budget planning purposes in the early stages of concept development of a project. It replaces what were formerly “Class C and D Estimates”. It is an order-of-magnitude estimate that is not sufficiently reliable to warrant Treasury Board approval as a cost objective. It is usually based on an operational statement of requirement, on a market assessment of products and technological availability that would meet the requirement, and on other considerations such as implementation, life cycle costs and operational savings. Preliminary Project Approval from the Treasury Board is normally based on an indicative cost estimate. According to Public Works’ Project Management Standard, it is generally accepted to have a plus or minus 15 to 20 percent level of accuracy with respect to construction projects.

A “substantive estimate” is one of high quality and reliability and is based on detailed system and component design, design adaptation, workplans and drawings for components, construction or assembly, and installation. It replaces what were formerly “Class A and B Estimates”. It includes site acquisition, preparation and any special requirement estimates. Contingency funding requirements must be justified based on line-by-line risk assessments, including market factors, industrial capability and labour considerations. It also includes the cost of all significant and identifiable deliverables, as well as the costs of the government’s contribution to employee benefit plans. Effective Project Approval from the Treasury Board is normally based on a substantive cost estimate. According to Public Works’ Project Management Standard, it is generally accepted to have a plus or minus 5 to 10 percent level of accuracy with respect to construction projects.

The Department of Foreign Affairs and International Trade informed us that a preliminary cost projection with a margin of accuracy of plus or minus 15 to 20 percent is reasonable for seeking preliminary project approval in the domestic environment with a suitable allowance factored in to recognize the exigencies, risks and challenges of delivering capital projects abroad.

Exhibit 31.3

Projects With Significant Increases Between Indicative and Substantive Estimates

Project	Indicative Estimate (\$ millions) / Date	Substantive Estimate (\$ millions) / Date	Increase (\$ million) / %
New Delhi Chancery	\$14.0 June 1988	\$25.0 February 1993	\$11.0 79%
New Delhi Staff Quarters	\$3.8 February 1995	\$9.6 March 1997	\$5.8 153%
Seoul Office and Residential Complex	\$33.6 August 1994	\$55.2 August 1997	\$21.6 64%
Total	\$51.4	\$89.8	\$38.4 75%

31.31 We found that the budget increases for the New Delhi staff quarters were primarily due to poor cost estimation. For example, the unit costs did not reflect local conditions and insufficient allowances were made when determining the amount of gross space that would be needed to provide for the required net space. However, it is important to note that both the cost and quality of the new staff quarters are similar to those recently constructed for the British High Commission.

31.32 The Department of Foreign Affairs and International Trade should strengthen its capability to prepare preliminary cost estimates that have a sufficiently high degree of quality and reliability to support the Treasury Board's consideration of the project.

The quality of the analysis and reporting of options needs to be improved

31.33 According to the Department's property manual, alternative accommodation solutions should be analyzed and a ranking of feasible options should be documented and reported to senior management. We found instances where the analysis of several options that might have produced significant cost

savings were not adequately documented. We also found that the documentation supporting the preferred option was incomplete. This lack of adequate documentation of the analysis of options raises questions as to the quality of the analysis carried out in support of recommendations made to senior departmental management and to the Treasury Board.

31.34 Geneva chancery. In December 1995, when it became apparent that the cost of the new chancery in Geneva would significantly exceed the approved budget, the project team proposed condensing the footprint of the building and adding a floor. It was estimated that this option could have saved between \$2 million and \$3 million. A smaller footprint would have also obviated the need to acquire additional land (which is currently under consideration) and to move the services on site to accommodate a pedestrian right-of-way. In addition, a smaller footprint would have addressed security concerns about the close proximity of the proposed walkway to the chancery. The cost of purchasing additional land and landscaping is estimated at \$500,000.

31.35 Documentation supporting the decision to exclude the official residence

Seoul Diplex Project

In June 1994, on the basis of a build-versus-lease cost analysis that favoured the build option, the Department of Foreign Affairs and International Trade sought preliminary project approval and spending authority from the Treasury Board to purchase a building site and construct a stand-alone diplomatic complex in Seoul, South Korea. The indicative cost of the total project was estimated at \$33.6 million (land cost: \$14.8 million; design fees and management: \$2.0 million; construction: \$12.3 million; relocation and fit-up cost: \$4.5 million). The Treasury Board approved the proposal in August 1994 and, in December 1994, the Department purchased a site in Seoul's Central Business District for approximately \$15 million.

We found that the indicative project cost estimate used to justify the build option was incomplete and not reliable. For example, it was not based on sound local knowledge and experience of the region, its construction industry and intended procurement method. The Department did not secure a comprehensive and reliable indicative estimate of the project's construction cost until April 1996, almost two years after seeking Treasury Board approval. A cost-consulting firm hired by the Department in early 1996 estimated the project's construction cost at \$25.8 million, a 110 percent increase compared with the 1994 estimate of \$12.3 million. If a reliable indicative estimate had been obtained in 1994, the project would have been judged to be uneconomical and the Bureau might not have spent \$15 million to purchase a site that has since been vacant. Using the Bank of Canada's five-year borrowing rate of interest in December 1994, we calculated that the opportunity cost of spending \$15 million on land that has been idle for about five years totalled approximately \$8 million.

in the chancery design is not available. We noted that on at least two occasions during March and April 1995, the portfolio manager informed Bureau management of the possibility of constructing an official residence on the new chancery site in Geneva. It was estimated that the additional cost would range from about \$525,000 to \$1.2 million. The Department is currently spending approximately \$470,000 per year to rent and maintain its leased official residence.

31.36 Departmental officials told us that the planning process does not provide a number of equal and comparable design options, with pros and cons that can be applied against a cost framework. They also said that the architectural planning of a building is an evolutionary process, originating with the need to construct on a piece of land and subject to a prescribed set of requirements that aims to meet an approved budget within an agreed period of time.

31.37 In our opinion, the options analysis carried out for the new chancery in Geneva did not provide sufficient substantiation for the decision to pursue the existing design. We believe that the potential cost savings, which we estimate to be at least \$7 million over a 20-year period, were of a nature and significance to warrant a formal review and consideration by senior management.

31.38 Bangkok chancery. In the case of the Bangkok chancery, we noted that there has been a long history of debate between the Physical Resources Bureau and the Mission over whether to lease or own space. Several Heads of Mission recommended a co-located, purchased property as an ideal solution to escalating rental costs, and poor environmental conditions. A lease-versus-purchase analysis for the chancery prepared by the Bureau in 1995 concluded that it was more economical to purchase than to lease. We noted that during the period

1995-96, the Department's preference shifted to a leased chancery solution. In support of this change, we expected to find an updated needs assessment and options analysis. The Bureau informed the Treasury Board that the selected lease solution was based on a careful screening of the various buildings within the Mission's locational parameters and a detailed evaluation was carried out. We noted, however, that a detailed feasibility report containing the needs assessment and options analysis does not exist. Consequently, the Bureau cannot demonstrate that the lease option was the most appropriate decision.

31.39 We also noted that a comprehensive options analysis of the planned project in Seoul, South Korea was lacking. For example, the option of including the official residence in the project was not formally evaluated. The Department has recently purchased the official residence that it had been leasing and is re-evaluating its need for office space and staff accommodation in Seoul.

The methodology used to support investment decisions needs to be improved

31.40 The Department of Foreign Affairs and International Trade carries out an investment analysis to support decisions regarding the financial viability of undertaking investment options and/or determining the costs of holding/disposing real property. We noted that little documentation exists to support the financial variables and cash flows used in the analysis. We are concerned that the investment analysis prepared by the Physical Resources Bureau to support the Seoul project may have been flawed. We discussed our concerns with management and agreed that an independent consultant be engaged to review the investment methodology, using the Seoul project as a case study. Prior to engaging an independent consultant, the Bureau's internal investment analysis had concluded, on several occasions, that the

We believe that the potential cost savings, which we estimate to be at least \$7 million over a 20-year period, were of a nature and significance to warrant a formal review and consideration by senior management.

proposed construction project was the most economically viable option.

31.41 The consultant's report, dated 31 March 1999, confirmed our concerns about the quality and reliability of the economic analysis. The report analyzed three different lease-versus-purchase scenarios, using the Bureau's own figures for the Seoul project, and concluded that the lease option would cost \$3 million to \$19 million less depending on the assumptions used. The report noted that while the formulae and calculations are sound, the following weaknesses exist in the investment analysis model:

- The model does not break out cash flow by type or by year, thereby making it difficult for decision makers to visualize the analysis.
- The model as presently constructed does not easily accommodate alternative options to lease or construct.

- The model does not include a summary report to accommodate sensitivity analysis and reporting.

- The discount rate relative to that used by other organizations appears low.

31.42 The Physical Resources Bureau should identify and analyze all reasonable alternatives that could potentially fulfil requirements, with the results being reported to senior management and the Treasury Board. The rationale for the selected option should be documented.

We found that the projects were generally delivered within their approved budgets and that the nature and extent of project delays were reasonable.

Implementation

Projects were generally delivered within budgets and project schedules

31.43 Exhibits 31.4 and 31.5 summarize the performance of completed projects as measured against their planned budgets and schedules. We found that these projects were generally delivered within their approved budgets and that the

Project	Indicative Estimate	(\$ millions)		Variance Between Substantive and Actual
		Substantive Estimate	Actual Cost	
New Delhi Chancery	14.0	25.0	25.8	(.8)
New Delhi Staff Quarters	3.8	9.6	9.1	.5
New Delhi Official Residence	1.3	1.3	1.5	(.2)
Bangkok Fit-up	2.9	2.9	3.2	(.3)
Geneva Chancery	21.4	21.4	20.0	1.4
Total	43.4	60.2	59.6	.6

Exhibit 31.4

Financial Performance of Completed Projects

(\$ millions)

Project	Preliminary Project Completion	Effective Project Completion	Actual Completion	Delay Between Effective and Actual Completion (months)
New Delhi Chancery	August 1991	September 1996	February 1997	5
New Delhi Staff Quarters	March 1997	July 1998	March 1999	8
New Delhi Official Residence	June 1997	June 1997	June 1997	0
Bangkok Fit-up	October 1997	December 1997	February 1998	2
Geneva Chancery	April 1998	April 1998	July 1999	15

Exhibit 31.5

Summary of Project Completion Versus Planned Dates

nature and extent of project delays were reasonable. For example, the delay in the Geneva project arose because of the need to follow due process as a result of environmental and historical concerns raised by a special interest group over the development of the site. With respect to the staff quarters project in New Delhi, India, the delay was mainly due to the additional time required to obtain imported materials.

31.44 As previously mentioned, the construction contract for the Seoul project has recently been terminated. We support the Department's decision to reassess its accommodation requirements and options in Seoul, South Korea because, in our view, the original project was poorly planned and could not be justified on economic grounds, as the Department had asserted.

Contracts were generally awarded on a competitive basis and change orders were well managed

31.45 We reviewed contracts totalling \$36 million. We found that the bidding and evaluation process was well documented and contracts were generally

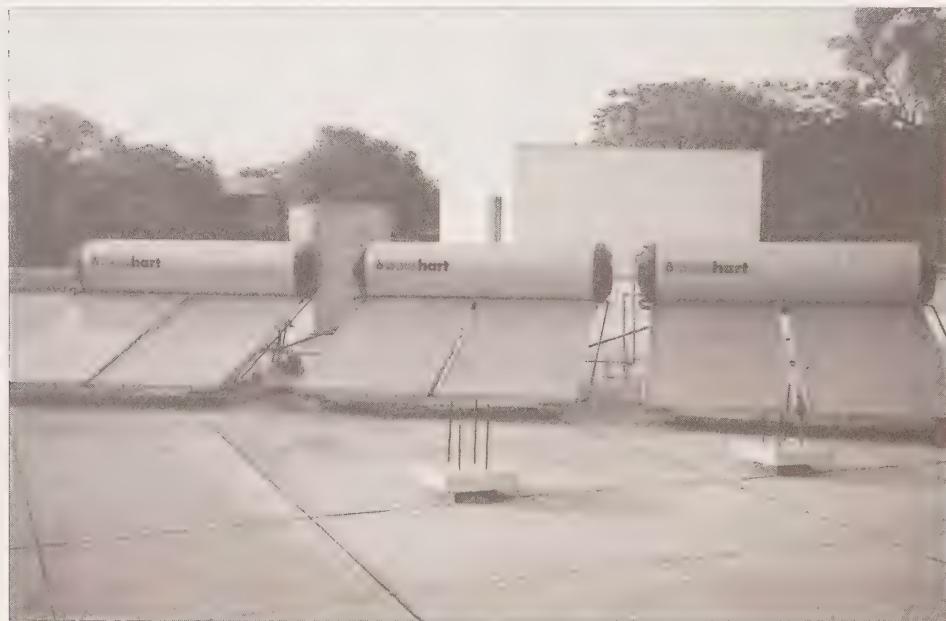
awarded on a competitive basis. In most of the cases, the lowest bid was selected and valid reasons existed when the lowest bid was not selected. We also reviewed a judgmental sample of change orders totalling \$1.6 million, representing approximately 43 percent of total change orders. We found that the changes were justified, well documented and properly approved.

Several positive initiatives address environmental concerns

31.46 Under the Code of Environmental Stewardship contained in Canada's *Green Plan*, the federal government has committed itself to show leadership in environmental matters. Under the Code, departments are obligated to address, among other things, energy and water conservation. In the course of our examination, we noted several positive environmental initiatives that the Department had undertaken.

31.47 Reduced energy use in New Delhi. The level of energy consumption has been significantly reduced in the New Delhi compound. As well, the chancery addition project included significant upgrades to the electrical and mechanical

Solar Panels Used to Heat Water at the Official Residence in New Delhi, India (see paragraph 31.47).



systems. As a result of these upgrades, energy costs of the chancery have remained essentially the same despite doubling the size of the facility. We also noted that solar water heating panels were installed at the official residence in an effort to reduce energy consumption. A recent energy audit and equipment assessment of the Canadian High Commission in New Delhi, India, conducted by Natural Resources Canada, identified the potential for further savings related to energy and water use, including sewer water reclamation.

31.48 Assessing air quality in New Delhi. The air quality in New Delhi is a significant problem and a serious concern and priority of the Mission. The World Health Organization described New Delhi as the fourth most polluted city in the world and the situation continues to worsen. We noted that the Mission has begun to gather data in order to analyze the quality of air in its facilities.

31.49 Minimizing energy consumption in Geneva. Efforts have been made in Geneva to minimize energy consumption. The project's design brief called for the selection of equipment that minimized life cycle costs, for projected maintenance, and for energy consumption over the equipment's life. We noted that a superior heating and cooling system was installed that is expected to significantly reduce energy consumption. However, the Department could not quantify the level of expected energy savings at the time of our audit.

Improved tracking of costs and reporting is required

31.50 Good project management requires that all costs associated with the project be tracked and compared against budget. Accurate and timely reporting of budget variances allows decision makers to address any significant variance or exception. We found that all project costs were not being systematically tracked and

reported to senior management and to the Treasury Board as required by Treasury Board policies for managing capital projects. This issue is of particular importance in the case of projects that consume significant internal resources over long periods of time, such as the New Delhi chancery expansion project that extended over a period of 15 years.

31.51 Using departmental estimates where available, we calculated that the cost of internal resources substantially dedicated to the New Delhi chancery expansion and staff quarters project totalled at least \$800,000 and \$560,000 respectively, excluding the cost of related travel and other out-of-pocket expenses. A similar calculation for the planned Seoul project resulted in a figure of \$522,000. The Department could not provide us with the estimates for the Bangkok and Geneva projects.

31.52 With respect to the Geneva project, we found that the Bureau was in the process of establishing separate projects for landscaping and the purchase of additional land at a total estimated cost of \$500,000. In our opinion, these activities are directly related to the new Chancery and their cost should be charged to the project.

31.53 We noted several weaknesses in the reporting of project performance to senior management. Reports that monitor project progress (scope, cost and schedule) against plans were not produced on a regular basis. Officials told us that project completion and evaluation reports are seldom produced in a timely manner due to lack of resources. Bureau management relies primarily on meetings and discussions with officials and on a weekly review of the Long-Term Capital Plan monthly cash flow reports to keep apprised of the status of projects. There is also a view within the Department that capital projects do not receive sufficient attention by senior management. We believe that formal reporting and review

**We are concerned
about the accuracy
and completeness of
statements in various
Treasury Board
submissions.**

practices would result in better project management.

31.54 The Physical Resources Bureau should track and allocate all costs specifically identifiable with a particular project. The Bureau should prepare reports that monitor project progress (scope, cost and schedule) against plans to allow decision makers to address any significant variance or exception.

Inconsistent compliance with Treasury Board policies is a concern

31.55 We noted two instances where the Department had exceeded its delegated authority and Treasury Board approval was granted retroactively. In one instance, the Department signed a three-year lease at an annual rent of \$785,000 prior to seeking Treasury Board approval. In addition, a \$400,000 deposit was made by the Mission to the landlord before the lease was signed. However, in seeking retroactive approval to enter into the lease, the Department did not inform the Treasury Board of the \$400,000 payment.

31.56 In a second instance, the Department had amended a consultant agreement by \$2.4 million without prior Treasury Board approval.

31.57 Finally, as illustrated by the case study below and as also noted in paragraph 31.30, we are concerned about the accuracy and completeness of statements in various Treasury Board submissions, such as those justifying project budget increases; they appear to be inconsistent with our audit evidence.

31.58 The Department of Foreign Affairs and International Trade should ensure consistent compliance with its delegated authorities.

Recent internal audits of three capital projects have identified concerns about project management practices

31.59 The Department's Inspector General recently issued draft reports on the audit of three capital projects: Algiers Diplomatic Complex, New York Consulate General lease fit-up, and Canada House refurbishment in London. A draft summary report of all three projects was also issued. At the end of our audit, the reports had not yet been finalized. Accordingly, we were not able to formally review the reports and supporting working papers and therefore could not determine the extent to which we could rely on the work. However, based on our discussions with the Inspector General's Office, we noted that its findings are similar to the issues and observations raised in this chapter.

Inaccurate and Incomplete Reporting to the Treasury Board

In August 1994, the Department obtained Treasury Board approval to design and construct a diplomatic complex (chancery plus staff quarters) in Seoul, South Korea at an estimated cost of \$33.6 million. The project was expected to be completed by December 1997. In August 1997, the Department informed the Treasury Board that the estimated project cost had increased to \$55.2 million, with a target occupancy date of June 2000. The increase was attributed to a combination of inadequate information on Korean construction costs at the time, the failure to include the payment of value-added tax as a project cost, and inflation in the Korean construction market. The Department maintained that the only real test of cost is the marketplace, and the tendered cost of the acceptable proposal exceeded the generic cost estimate.

As noted previously, we found that the 1994 project cost estimate was incomplete and unreliable. The Department did not prepare a proper cost estimate until April 1996. In our view, poor estimation of project cost in 1994 was the primary reason for the need to increase the project budget in 1997. We also expected that the Department would have informed the Treasury Board as to the reason(s) for the 2.5 year project delay from December 1997 to June 2000.

Commissioning

Consistent commissioning practices will decrease project risk

31.60 Commissioning is a sequential method of testing and validating results against expected performance criteria for all building components and equipment, systems and integrated systems. We found that commissioning practices varied among several of the projects reviewed.

31.61 New Delhi chancery. Funds were allocated for commissioning in the project budget. Although a formal commissioning plan was not prepared, commissioning activities were appropriately carried out and we did not observe any significant problems. Users indicated that they are generally satisfied with the building's services.

31.62 Geneva chancery. We found that the project budget did not include funds to plan and carry out commissioning. In fact, a commissioning plan had not yet been prepared just days before the building was scheduled for substantial completion. We noted that four different commissioning officers had been involved with the project during the prior eight months. Without a sound commissioning plan and testing, the Department would not have independent assurance that the building's systems will function as intended. Also, there is a greater risk that deficiencies will not be identified prior to acceptance of the building. Project officials have recently informed us that a \$130,000 commissioning contract was awarded on 7 July 1999. Commissioning is expected to be completed by the end of October 1999.

31.63 The Department of Foreign Affairs and International Trade should ensure that projects are commissioned so that program requirements are satisfied with minimum cost and disruption.

Project Files

Project files are maintained in an ad hoc fashion and do not clearly demonstrate closure of issues

31.64 Well-organized and complete project files support effective project management. This is particularly important for the Department of Foreign Affairs and International Trade as it manages projects around the world. Separations of time, distance and foreign cultures, along with the rotational assignment of personnel, underscores the importance of maintaining proper files, which avoids unnecessary revisit of issues previously studied and analyzed. We noted that project files are generally maintained in an ad hoc fashion and do not fully and easily capture important decisions and conclusions. In particular, we are concerned that project files do not clearly indicate the resolution of issues.

31.65 In Bangkok, departmental officials expressed concerns over a lease signed in 1995 relating to fixtures and furniture for the official residence. During our field visit, we noted that the project files did not indicate whether these concerns had been addressed. In the case of the New Delhi official residence, various options had been presented and discussed for the development of this site prior to the recent renovation. However, we noted that important information supporting the decision was not documented in the project files.

Conclusion

The projects were successfully implemented, but better planning and analysis of options are required

31.66 Our audit findings and observations relate only to the projects examined. Although the findings seem to point to some systemic planning weaknesses that should be investigated by management, we did not audit the

We conclude that the facilities meet the users' stated requirements.

Physical Resources Bureau, the Geographic Branches or the missions in their entirety. We conclude that the facilities meet the users' stated requirements. Officials at the missions we visited generally expressed a high level of satisfaction with their new accommodation. They believe that the facilities enable them to better deliver their programs and have improved staff morale. Overall, the projects were delivered within approved budgets and project schedules. We also noted several positive initiatives to address environmental concerns.

31.67 Capital projects commit the Crown to large one-time capital expenditures and often to even greater ongoing operating and maintenance costs over the life of the asset. It is therefore crucial that reliable estimates of the projects' total costs be provided to senior management and the Treasury Board before the projects become committed. It is equally important that all reasonable options for significant cost savings be explored and reported to senior management and the Treasury Board. We noted weaknesses in both these areas.

31.68 The quality of analysis and documentation used to support investment decisions fell short of that required by the Department's own policies and established methodologies for managing capital projects. The Physical Resources Bureau needs to further improve the way it tracks and reports project costs and budget variances. In addition, we noted two instances in which the Department had exceeded its delegated contracting authority and the Treasury Board approval was granted retroactively. Recent internal audits of three capital projects have

identified similar concerns about the Department's project management practices. In our opinion, all of the above-noted factors may have resulted in additional costs ranging from at least \$8 million to \$15 million over a 20-year period.

31.69 The Physical Resources Bureau has taken initiatives in the past few years to improve its project management systems and practices. We would expect that the Bureau would take into account in its management improvement initiatives the concerns raised by this audit as well as those raised by the Department's Office of the Inspector General. We also encourage the Inspector General to continue to give priority to this aspect of the Department's operations. We plan to monitor future projects delivered by the Physical Resources Bureau and report to Parliament, as appropriate.

Department's overall response: The Department agrees with the Auditor General's recommendations. Project delivery performance has focussed on ensuring that projects are viable and justified based on final cost estimates prior to proceeding. However, preliminary cost estimates have sometimes failed to predict the evolution of program requirements, or market forces during subsequent project planning stages.

The Department will continue to re-evaluate the rationale for capital projects whenever cost estimates change and, as in the case of Seoul, whenever indicated by volatile local property markets.

Project documentation, investment analysis, and reporting to the Treasury Board will continue to be improved.



About the Audit

Objectives

The objectives of the audit were to determine whether the selected facilities meet the clients' requirements and Treasury Board approvals, and whether they were planned and implemented with due regard to economy and efficiency, taking into account environmental considerations.

Scope

We examined the major aspects of the selected projects from the perspective of generally accepted practices of good project planning and implementation. Specifically, we reviewed the needs definition and statement of requirements, options analysis, project definition and approval, design and contracting, construction and commissioning phases, as appropriate. Our review of departmental program issues was limited to obtaining a general understanding of the program requirements that the new facilities were designed to meet. Except for their role in the projects examined, we did not audit the Physical Resources Bureau, the Geographic Branches or the missions. The commissioning phase for the Geneva chancery had not been completed by the end of our field work.

Criteria

Our audit criteria were derived from the established methodologies of the Office of the Auditor General for auditing capital asset projects and from the Treasury Board policies for managing capital projects. We also took into account the Physical Resources Bureau's Project Delivery System that elaborates on Treasury Board policies for managing capital projects.

Approach

We interviewed most of the key departmental program and project officials and reviewed relevant project files and documents. Our fieldwork included site visits to all of the projects. During our site visits, we also looked at several projects completed for other countries.

Audit Team

Assistant Auditor General: Shahid Minto

Director: Joe Martire

Rodney Newcombe

Elizabeth Fox

For information, please contact Joe Martire.

The Department of Foreign Affairs and International Trade provided the following action plan in response to our recommendations.

THE DEPARTMENT'S ACTION PLAN

The Department will continue its ongoing improvements to the Property Program, including measures to address issues raised by the Auditor General.

- **The analysis of property options, and estimation of future projects costs, will be further improved:**
 - The practice, begun in 1996, of contracting with internationally experienced quantity surveyors to obtain independent project cost estimates will be continued.
 - In November 1999, the Department will call for expressions of interest to provide cost estimation services through standing offers.
 - Implementation of the recommendations in the March 1999 independent review of the investment analysis methodology will be continued.
 - In January 2000, the Department will complete its revised guidelines for conducting feasibility studies.
- **The Department will examine methods for calculating and reporting the overhead costs of project administration.**
- **Best practices for reporting of project performance and documentation will continue to be introduced:**
 - In February 1999, electronic project files were established for new projects.
 - In late 1999, the “Project Systems” module in the Department’s new integrated financial management system will be implemented.
- **An updated guide to Treasury Board contracting and financial authorities will be disseminated within the Department, and progress on the Action Plan will be reported to the Treasury Board in 2000.**

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to the House of Commons

Chapter 31
Department of Foreign Affairs and International Trade –
Delivery of Capital Projects in Four Missions

November 1999

This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 31

**Department of Foreign Affairs and
International Trade**

**Delivery of Capital Projects
in Four Missions**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Department of Foreign Affairs and International Trade

Delivery of Capital Projects in Four Missions

Main Points

31.1 This audit examined how the Department of Foreign Affairs and International Trade planned and implemented six capital projects at four missions in Seoul, New Delhi, Geneva and Bangkok. Capital costs for these missions totalled about \$75 million, representing approximately 20 percent of the capital expenditures planned by the Department over the five-year life of its Long-Term Capital Plan.

31.2 Delivering capital projects outside of Canada entails significant additional risks, difficulties and challenges not experienced in the delivery of capital projects domestically.

31.3 The audit confirmed that valid reasons existed for initiating each of the projects and that users are generally satisfied with their new accommodation. Overall, the projects were delivered within budgets and project schedules. In general, contracts were awarded on a competitive basis and change orders were well managed. We noted several positive initiatives to address environmental concerns.

31.4 However, we identified weaknesses in the preliminary planning of the projects. Indicative project estimates were incomplete and unreliable. The preliminary cost estimates of three projects increased by \$38 million, representing increases ranging from 64 percent to 153 percent over their initial estimates. In one case, a poor cost estimate may have resulted in an uneconomical expenditure of \$15 million. We estimate that, over the last five years, the opportunity cost of this payment totals \$8 million.

31.5 We are also concerned with the lack of rigour of the Department's analysis of options in support of their recommendations to the Treasury Board. We found instances where the Department failed to document the results of its analysis of various options that may have realized savings totalling at least \$7 million over a 20-year period. We also noted weaknesses in the methodology used by the Department to support its investment decisions, and the lack of documentation to support a particular option.

31.6 The quality of reporting to the Treasury Board to explain project delays and budget increases needs to be improved.

31.7 In summary, the magnitude and frequency of increases in preliminary cost estimates and other problems identified by the audit seem to indicate that systemic weaknesses exist in the Department's planning of capital projects and these need to be addressed.

Background and other observations

31.8 The Department of Foreign Affairs and International Trade manages a significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries. The estimated value of these Crown-owned properties abroad is \$1.5 billion to \$2 billion and annual leasing and capital expenditures total approximately \$110 million and \$60 million respectively. The Department and other government departments use the facilities to deliver their programs.

31.9 This audit reaffirmed our opinion that the government's administrative policies for managing capital projects are sound, but problems persist in their application.

The Department of Foreign Affairs and International Trade agrees with the chapter's recommendations and has developed an action plan that addresses our concerns.

Introduction

31.10 Acquisition, management and disposal of capital assets by all government departments amounts to more than \$10 billion annually. Capital assets include, but are not limited to, land, buildings, works, inventory and equipment. Departments require them for the fulfilment of their mandates and delivery of their operational programs.

31.11 Our review of the government's Part III Estimates for 1997–98 identified planned expenditures of more than \$32 billion over the time required to complete 159 projects, each costing \$10 million or more. The magnitude of these numbers indicates the importance of sound management of this aspect of government operations. Improvements in the planning, design, acquisition, and operating and maintenance of capital projects over their life cycle can result in significant savings to the government.

Audit strategy for capital projects across government departments

31.12 Our Office audits capital projects on a selective basis, taking into account cost, risk and sensitivity. Recent audits include the Parliamentary Precinct Restoration and Renovation Program, the Federal Laboratories for Human and Animal Health Building Project and buying of major capital equipment by National Defence. These and previous audits identified a range of deficiencies in the approval and management practices that resulted in project delays, increased costs and lack of value for money. We continue to audit capital projects on a selective basis across government departments.

Responsibility for capital projects in the Department of Foreign Affairs and International Trade

31.13 The Department of Foreign Affairs and International Trade manages a

significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries. The Department estimates that the value of these Crown-owned properties abroad is about \$1.5 billion to \$2 billion and annual leasing and capital expenditures total approximately \$110 million and \$60 million respectively.

31.14 Within the Department, responsibility and decisions relative to major capital expenditures are shared among the Department's Executive Committee, Physical Resources Bureau (the Bureau), the Geographic Branches and the missions.

31.15 The Bureau is responsible for strategic property planning, analysis and reporting to senior management and the Treasury Board, as appropriate; the implementation and delivery of major capital projects; and the provision of technical services to support the operation and maintenance of facilities abroad. It manages the Long-Term Capital Program, the acquisition (purchase or lease) and construction of chanceries and official residences, the purchase or construction of staff quarters, and major renovation and maintenance projects.

31.16 The Geographic Branches identify property needs, provide assistance and input to the Bureau in prioritizing those needs, and allocate the necessary resources to the missions for the day-to-day operation and maintenance of property abroad, including funding for leasing costs.

31.17 Missions are responsible for the leasing of staff quarters, for landlord-tenant relationships in leased chanceries or official residences, for the day-to-day operation and management of all property in their inventory and for minor maintenance projects. Missions also play an important role in identifying their property needs and assist the Bureau by providing information about local property markets. Other government

The Department of Foreign Affairs and International Trade manages a significant and diverse portfolio of office and residential accommodation, encompassing property in 160 locations in over 100 countries.

We examined six projects which are being delivered by the Department of Foreign Affairs and International Trade in four missions.

departments identify their property needs abroad and work with the Bureau to fulfil those needs.

Focus of the audit

31.18 We examined six projects, described in Exhibit 31.1, which are being delivered by the Department of Foreign Affairs and International Trade in four missions. These projects have capital

expenditures totalling about \$75 million, representing approximately 20 percent of the capital expenditures planned by the Department over the five-year life of its Long-Term Capital Plan. They comprise a mix of chanceries, staff quarters and an official residence. In selecting the projects, we took into account the project's cost, sensitivity, location (developed and developing countries),

Exhibit 31.1

Projects Selected for Audit



Planned \$55.2 million office and residential complex in Seoul, South Korea

economic crisis. At the time that the construction contract was cancelled, the estimated cost of the project had increased to \$55.2 million, with a revised completion date of summer/fall of 2001. To date, approximately \$17.2 million has been spent on acquisition of the site, design development, costs for contract termination and project management, including travel.



\$25.8 million addition to the existing chancery in New Delhi, India

1993, with completion in September 1996. The project was delivered on budget and approximately five months behind schedule.



18 new staff quarters costing \$9.1 million in New Delhi, India

1. In December 1994, the Department purchased a site in Seoul's Central Business District for approximately \$15 million. During preliminary planning, the project envisaged the design and construction of office and residential accommodation, with a combined gross area of approximately 6,600 square metres at an estimated cost of \$33.6 million, including land. The project was to be completed by December 1997. The Department recently informed us that it has terminated the construction contract and is reassessing its accommodation requirements and options in Seoul due to the increasing availability and lower cost of leased space following the Asian

2. The New Delhi chancery project consisted of construction of an addition to the existing chancery, covering a gross area of approximately 3,380 square metres (which approximately doubled its capacity), as well as upgrading of mechanical and recreational facilities. In June 1988, the Treasury Board provided Preliminary Project Approval of \$14 million to complete the project by August 1991. In February 1993, the Treasury Board approved an \$11 million increase primarily due to scope increases and unplanned travel and on-site management costs. Construction was planned to commence in March

3. The New Delhi staff quarters project comprised the construction of 18 new staff quarters on the compound. In February 1995, the Department approved a project budget of \$3.8 million, with the project to be completed by March 1997. In January 1997, the budget was increased to \$9.6 million, with a completion date of July 1998. Construction began in January 1997 and the staff quarters were fully occupied in March 1999. The final cost of the project was \$9.1 million.

type (lease, fit-up, construction), and status (work-in-process versus completed). We examined the major aspects of the projects from the perspective of generally accepted practices of good project planning and implementation.

31.19 Our interest in departmental program issues was limited to obtaining a

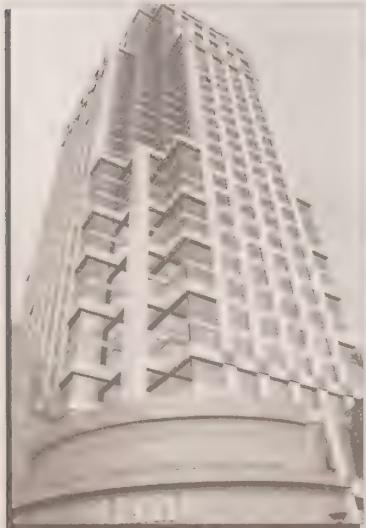
general understanding of the program requirements that the new facilities were designed to meet. Except for their role in the projects examined, we did not audit the Physical Resources Bureau, the Geographic Branches or the missions. Further details on the audit are found at the end of the chapter in **About the Audit**.



\$1.5 million reconstruction of the official residence in New Delhi, India



\$20.0 million new Canadian chancery in Geneva, Switzerland



\$3.2 million fit-up of the chancery in a new leased building in Bangkok, Thailand

Exhibit 31.1 (cont'd)

4. The New Delhi official residence project comprised a major reconstruction of the 65-year-old residence to replace various building components and systems, notably the roof, plumbing, air conditioning and electrical systems. The project was approved in June 1996 at an estimated cost of \$1.3 million and with a completion date of June 1997. The total cost of the project was \$1.5 million and it was delivered on schedule.

5. On 21 March 1996, the Treasury Board approved the purchase of land for the design and construction of a 2,200 net square metre chancery in Geneva, Switzerland at a total estimated cost of \$21.4 million. It was anticipated that the project would be completed by 1 April 1998. As at 29 September 1999, the building was substantially completed at a cost of \$19.5 million. The remaining cost to complete the project is estimated at \$500,000.

6. On November 1996, the Treasury Board approved a three-year lease with two three-year extension options, for approximately 1,980 square metres in a new Class A building, at an average annual rent of Baht 13,300,000 (C \$720,000). The Board also approved \$2.9 million for chancery fit-up and moving costs. The fit-up project was completed approximately two months behind schedule at a cost of \$3.2 million.

We identified variances between preliminary cost estimates and final project budgets, as well as other problems related to scheduling and project planning.

Observations and Recommendations

Risks and challenges in delivering projects abroad

31.20 Although we believe it is important that capital projects meet performance, cost and schedule objectives, we recognize that chanceries and official residences are used to promote Canadian presence and image abroad, which may result in higher costs. We also recognize that there are significant additional risks and challenges in delivering projects outside Canada. For example, the work must adhere to a wide variety of local building, health and safety, fire and environmental codes and comply with all applicable Canadian laws and regulations. Language and cultural differences also add to the complexity of doing business abroad.

31.21 The Department also has an obligation to provide Canadian based staff with living conditions similar to those in Canada, with respect to quality of accommodation. This is particularly important at posts where measures of isolation, location conditions, climate, health, medical care, hostility and violence exist. The Department has developed a “hardship level” one to five rating (five representing the greatest hardship) that is intended to recognize the existence of undesirable conditions at the various posts and to reinforce the importance of providing appropriate accommodation that meets Canadian standards. The hardship levels for the missions that we examined are:

- Bangkok, Thailand — Level III
- Geneva, Switzerland — N/A
- New Delhi, India — Level IV
- Seoul, South Korea — Level III

Government administrative policies for managing capital projects are sound, but problems persist in their application

31.22 Based on previous audits of capital projects, the Auditor General informed the Standing Committee on Public Accounts, on 4 June 1998, that the Treasury Board’s administrative policies for managing capital projects across the government are fundamentally sound and consistent with an environment of increased delegation of responsibilities to departments. We noted that during the past several years, the Treasury Board approved several significant reforms to allow the Department of Foreign Affairs and International Trade to operate in a more businesslike manner. For example, subject to the consideration and approval of an annual Business Plan by the Treasury Board, the Physical Resources Bureau was granted authority to spend in future years the sales proceeds generated by the disposal of properties in any current year in return for reduced dependence on appropriations. Moreover, various contracting authorities were also increased, with a view to making project approvals more efficient.

31.23 Although the government’s policies and guidelines on capital projects are sound, problems continue to persist in their application. We noted that the Bureau has undertaken a number of initiatives to improve the planning, management and delivery of capital projects by the Department; however, we identified variances between preliminary cost estimates and final project budgets, as well as other problems related to scheduling and project planning. These indicate that opportunities for improvement exist and that management needs to continue to focus on this aspect of the property program. We also noted that the Inspector General’s audit of three other capital projects identified similar concerns with project planning. Accordingly, we believe that management needs to address the concerns raised by

both audits. We also encourage the Inspector General's Office to continue to give priority to this aspect of the Department's operations.

Planning

The projects were justified and users are generally satisfied

31.24 The audit confirmed that valid reasons existed for initiating each of the projects and users are generally satisfied with the results. In the case of New Delhi, the need to expand the existing chancery dates back to 1982 when the immigration programs began to increase significantly. Additional staff quarters were constructed to replace some of the older staff quarters and in response to concerns among the diplomatic community in New Delhi about the deteriorating quality of rental accommodations. The already expensive rental costs that were anticipated to continue to rise over the next few years (projections of up to 150 percent) were also a concern among the diplomatic community. The official residence is located in a historical and architecturally significant section of New Delhi. It is a 65-year-old building that required major reconstruction.

31.25 In Bangkok, the purpose of the relocation was to reduce the amount of space and to upgrade the quality of accommodation as the Mission had occupied the facility for over 20 years. We confirmed that the previous premises were old and were scheduled to have been torn down and redeveloped. The Ambassador reported that staff are very satisfied with their new work environment and morale has improved. The staff we spoke to confirmed these views.

31.26 The rented premises in Geneva were one of the Department's most expensive leases. We found that the Department acted appropriately in taking advantage of an economically viable opportunity to secure a long-term

Crown-owned solution for its accommodation requirements. Mission management told us that the new facility will enable them to deliver their programs more effectively and to better accommodate the large number of government officials who conduct business in Geneva.

31.27 The need to seek alternative accommodation in Seoul, South Korea was in response to the landlord's request to vacate the premises in order to carry out needed renovations to the building, and to secure a long-term Crown-owned solution for the Department's accommodation requirements. The Mission and Geographic Branch initially approved the proposed project, consisting of one tower of office space and one tower for residential accommodation. However, current Mission staff have since expressed concern with the proposed project to combine office and residential accommodation in the same building complex. During our field trip, management and staff at the Mission reconfirmed the need to relocate and expressed a high level of dissatisfaction with their current office accommodation. They supported pursuing options to secure new alternative accommodation as soon as possible.

Preliminary project estimates were incomplete and unreliable

31.28 Treasury Board policy on capital projects states that cost estimates must have a sufficiently high degree of quality and reliability to support Treasury Board's consideration of the project or specific phase of the project. For greater clarity, the Treasury Board requires that estimates be prepared as indicative and substantive, as described in Exhibit 31.2.

31.29 Exhibit 31.3 illustrates that the preliminary budgets of three of the six projects examined experienced increases, totalling \$38 million and ranging from 64 percent to 153 percent over their initial estimates, due to changes

The preliminary budgets of three of the six projects examined increased by \$38 million, representing increases ranging from 64 percent to 153 percent over their initial estimates.

in the projects' scope and to poor cost estimation. As a result, management and the Treasury Board did not have a reliable estimate of the project's cost prior to granting preliminary approval. The case study on page 31–13 provides an example of how a poor cost estimate was used to support an uneconomical investment option that may have led to an unproductive \$15 million expenditure.

31.30 In the case of the New Delhi chancery, the Department informed the

Treasury Board that the additional costs were necessary to correct deficiencies in the existing facilities. The costs were mainly due to upgrades to the mechanical systems in the existing building as a result of on-site inspections, to improvements in the recreational facilities, and to other unplanned costs for travel and on-site management. We believe that most of these costs could have reasonably been identified prior to seeking preliminary project approval.

Exhibit 31.2

Indicative and Substantive Cost Estimates

An “indicative estimate” provides a rough cost projection used for budget planning purposes in the early stages of concept development of a project. It replaces what were formerly “Class C and D Estimates”. It is an order-of-magnitude estimate that is not sufficiently reliable to warrant Treasury Board approval as a cost objective. It is usually based on an operational statement of requirement, on a market assessment of products and technological availability that would meet the requirement, and on other considerations such as implementation, life cycle costs and operational savings. Preliminary Project Approval from the Treasury Board is normally based on an indicative cost estimate. According to Public Works’ Project Management Standard, it is generally accepted to have a plus or minus 15 to 20 percent level of accuracy with respect to construction projects.

A “substantive estimate” is one of high quality and reliability and is based on detailed system and component design, design adaptation, workplans and drawings for components, construction or assembly, and installation. It replaces what were formerly “Class A and B Estimates”. It includes site acquisition, preparation and any special requirement estimates. Contingency funding requirements must be justified based on line-by-line risk assessments, including market factors, industrial capability and labour considerations. It also includes the cost of all significant and identifiable deliverables, as well as the costs of the government’s contribution to employee benefit plans. Effective Project Approval from the Treasury Board is normally based on a substantive cost estimate. According to Public Works’ Project Management Standard, it is generally accepted to have a plus or minus 5 to 10 percent level of accuracy with respect to construction projects.

The Department of Foreign Affairs and International Trade informed us that a preliminary cost projection with a margin of accuracy of plus or minus 15 to 20 percent is reasonable for seeking preliminary project approval in the domestic environment with a suitable allowance factored in to recognize the exigencies, risks and challenges of delivering capital projects abroad.

Exhibit 31.3

Projects With Significant Increases Between Indicative and Substantive Estimates

Project	Indicative Estimate (\$ millions) / Date	Substantive Estimate (\$ millions) / Date	Increase (\$ million) / %
New Delhi Chancery	\$14.0 June 1988	\$25.0 February 1993	\$11.0 79%
New Delhi Staff Quarters	\$3.8 February 1995	\$9.6 March 1997	\$5.8 153%
Seoul Office and Residential Complex	\$33.6 August 1994	\$55.2 August 1997	\$21.6 64%
Total	\$51.4	\$89.8	\$38.4 75%

31.31 We found that the budget increases for the New Delhi staff quarters were primarily due to poor cost estimation. For example, the unit costs did not reflect local conditions and insufficient allowances were made when determining the amount of gross space that would be needed to provide for the required net space. However, it is important to note that both the cost and quality of the new staff quarters are similar to those recently constructed for the British High Commission.

31.32 The Department of Foreign Affairs and International Trade should strengthen its capability to prepare preliminary cost estimates that have a sufficiently high degree of quality and reliability to support the Treasury Board's consideration of the project.

The quality of the analysis and reporting of options needs to be improved

31.33 According to the Department's property manual, alternative accommodation solutions should be analyzed and a ranking of feasible options should be documented and reported to senior management. We found instances where the analysis of several options that might have produced significant cost

savings were not adequately documented. We also found that the documentation supporting the preferred option was incomplete. This lack of adequate documentation of the analysis of options raises questions as to the quality of the analysis carried out in support of recommendations made to senior departmental management and to the Treasury Board.

31.34 Geneva chancery. In December 1995, when it became apparent that the cost of the new chancery in Geneva would significantly exceed the approved budget, the project team proposed condensing the footprint of the building and adding a floor. It was estimated that this option could have saved between \$2 million and \$3 million. A smaller footprint would have also obviated the need to acquire additional land (which is currently under consideration) and to move the services on site to accommodate a pedestrian right-of-way. In addition, a smaller footprint would have addressed security concerns about the close proximity of the proposed walkway to the chancery. The cost of purchasing additional land and landscaping is estimated at \$500,000.

31.35 Documentation supporting the decision to exclude the official residence

Seoul Diplex Project

In June 1994, on the basis of a build-versus-lease cost analysis that favoured the build option, the Department of Foreign Affairs and International Trade sought preliminary project approval and spending authority from the Treasury Board to purchase a building site and construct a stand-alone diplomatic complex in Seoul, South Korea. The indicative cost of the total project was estimated at \$33.6 million (land cost: \$14.8 million; design fees and management: \$2.0 million; construction: \$12.3 million; relocation and fit-up cost: \$4.5 million). The Treasury Board approved the proposal in August 1994 and, in December 1994, the Department purchased a site in Seoul's Central Business District for approximately \$15 million.

We found that the indicative project cost estimate used to justify the build option was incomplete and not reliable. For example, it was not based on sound local knowledge and experience of the region, its construction industry and intended procurement method. The Department did not secure a comprehensive and reliable indicative estimate of the project's construction cost until April 1996, almost two years after seeking Treasury Board approval. A cost-consulting firm hired by the Department in early 1996 estimated the project's construction cost at \$25.8 million, a 110 percent increase compared with the 1994 estimate of \$12.3 million. If a reliable indicative estimate had been obtained in 1994, the project would have been judged to be uneconomical and the Bureau might not have spent \$15 million to purchase a site that has since been vacant. Using the Bank of Canada's five-year borrowing rate of interest in December 1994, we calculated that the opportunity cost of spending \$15 million on land that has been idle for about five years totalled approximately \$8 million.

in the chancery design is not available. We noted that on at least two occasions during March and April 1995, the portfolio manager informed Bureau management of the possibility of constructing an official residence on the new chancery site in Geneva. It was estimated that the additional cost would range from about \$525,000 to \$1.2 million. The Department is currently spending approximately \$470,000 per year to rent and maintain its leased official residence.

31.36 Departmental officials told us that the planning process does not provide a number of equal and comparable design options, with pros and cons that can be applied against a cost framework. They also said that the architectural planning of a building is an evolutionary process, originating with the need to construct on a piece of land and subject to a prescribed set of requirements that aims to meet an approved budget within an agreed period of time.

31.37 In our opinion, the options analysis carried out for the new chancery in Geneva did not provide sufficient substantiation for the decision to pursue the existing design. We believe that the potential cost savings, which we estimate to be at least \$7 million over a 20-year period, were of a nature and significance to warrant a formal review and consideration by senior management.

31.38 Bangkok chancery. In the case of the Bangkok chancery, we noted that there has been a long history of debate between the Physical Resources Bureau and the Mission over whether to lease or own space. Several Heads of Mission recommended a co-located, purchased property as an ideal solution to escalating rental costs, and poor environmental conditions. A lease-versus-purchase analysis for the chancery prepared by the Bureau in 1995 concluded that it was more economical to purchase than to lease. We noted that during the period

1995-96, the Department's preference shifted to a leased chancery solution. In support of this change, we expected to find an updated needs assessment and options analysis. The Bureau informed the Treasury Board that the selected lease solution was based on a careful screening of the various buildings within the Mission's locational parameters and a detailed evaluation was carried out. We noted, however, that a detailed feasibility report containing the needs assessment and options analysis does not exist. Consequently, the Bureau cannot demonstrate that the lease option was the most appropriate decision.

31.39 We also noted that a comprehensive options analysis of the planned project in Seoul, South Korea was lacking. For example, the option of including the official residence in the project was not formally evaluated. The Department has recently purchased the official residence that it had been leasing and is re-evaluating its need for office space and staff accommodation in Seoul.

The methodology used to support investment decisions needs to be improved

31.40 The Department of Foreign Affairs and International Trade carries out an investment analysis to support decisions regarding the financial viability of undertaking investment options and/or determining the costs of holding/disposing real property. We noted that little documentation exists to support the financial variables and cash flows used in the analysis. We are concerned that the investment analysis prepared by the Physical Resources Bureau to support the Seoul project may have been flawed. We discussed our concerns with management and agreed that an independent consultant be engaged to review the investment methodology, using the Seoul project as a case study. Prior to engaging an independent consultant, the Bureau's internal investment analysis had concluded, on several occasions, that the

We believe that the potential cost savings, which we estimate to be at least \$7 million over a 20-year period, were of a nature and significance to warrant a formal review and consideration by senior management.

proposed construction project was the most economically viable option.

31.41 The consultant's report, dated 31 March 1999, confirmed our concerns about the quality and reliability of the economic analysis. The report analyzed three different lease-versus-purchase scenarios, using the Bureau's own figures for the Seoul project, and concluded that the lease option would cost \$3 million to \$19 million less depending on the assumptions used. The report noted that while the formulae and calculations are sound, the following weaknesses exist in the investment analysis model:

- The model does not break out cash flow by type or by year, thereby making it difficult for decision makers to visualize the analysis.
- The model as presently constructed does not easily accommodate alternative options to lease or construct.

- The model does not include a summary report to accommodate sensitivity analysis and reporting.

31.42 The Physical Resources Bureau should identify and analyze all reasonable alternatives that could potentially fulfil requirements, with the results being reported to senior management and the Treasury Board. The rationale for the selected option should be documented.

Implementation

Projects were generally delivered within budgets and project schedules

31.43 Exhibits 31.4 and 31.5 summarize the performance of completed projects as measured against their planned budgets and schedules. We found that these projects were generally delivered within their approved budgets and that the

We found that the projects were generally delivered within their approved budgets and that the nature and extent of project delays were reasonable.

Project	Indicative Estimate	(\$ millions)		Variance Between Substantive and Actual
		Substantive Estimate	Actual Cost	
New Delhi Chancery	14.0	25.0	25.8	(.8)
New Delhi Staff Quarters	3.8	9.6	9.1	.5
New Delhi Official Residence	1.3	1.3	1.5	(.2)
Bangkok Fit-up	2.9	2.9	3.2	(.3)
Geneva Chancery	21.4	21.4	20.0	1.4
Total	43.4	60.2	59.6	.6

Exhibit 31.4

Financial Performance of Completed Projects
(\$ millions)

Project	Preliminary Project Completion	Effective Project Completion	Actual Completion	Delay Between Effective and Actual Completion (months)
New Delhi Chancery	August 1991	September 1996	February 1997	5
New Delhi Staff Quarters	March 1997	July 1998	March 1999	8
New Delhi Official Residence	June 1997	June 1997	June 1997	0
Bangkok Fit-up	October 1997	December 1997	February 1998	2
Geneva Chancery	April 1998	April 1998	July 1999	15

Exhibit 31.5

Summary of Project Completion Versus Planned Dates

nature and extent of project delays were reasonable. For example, the delay in the Geneva project arose because of the need to follow due process as a result of environmental and historical concerns raised by a special interest group over the development of the site. With respect to the staff quarters project in New Delhi, India, the delay was mainly due to the additional time required to obtain imported materials.

31.44 As previously mentioned, the construction contract for the Seoul project has recently been terminated. We support the Department's decision to reassess its accommodation requirements and options in Seoul, South Korea because, in our view, the original project was poorly planned and could not be justified on economic grounds, as the Department had asserted.

Contracts were generally awarded on a competitive basis and change orders were well managed

31.45 We reviewed contracts totalling \$36 million. We found that the bidding and evaluation process was well documented and contracts were generally

awarded on a competitive basis. In most of the cases, the lowest bid was selected and valid reasons existed when the lowest bid was not selected. We also reviewed a judgmental sample of change orders totalling \$1.6 million, representing approximately 43 percent of total change orders. We found that the changes were justified, well documented and properly approved.

Several positive initiatives address environmental concerns

31.46 Under the Code of Environmental Stewardship contained in Canada's *Green Plan*, the federal government has committed itself to show leadership in environmental matters. Under the Code, departments are obligated to address, among other things, energy and water conservation. In the course of our examination, we noted several positive environmental initiatives that the Department had undertaken.

31.47 Reduced energy use in New Delhi. The level of energy consumption has been significantly reduced in the New Delhi compound. As well, the chancery addition project included significant upgrades to the electrical and mechanical

Solar Panels Used to Heat Water at the Official Residence in New Delhi, India (see paragraph 31.47).



systems. As a result of these upgrades, energy costs of the chancery have remained essentially the same despite doubling the size of the facility. We also noted that solar water heating panels were installed at the official residence in an effort to reduce energy consumption. A recent energy audit and equipment assessment of the Canadian High Commission in New Delhi, India, conducted by Natural Resources Canada, identified the potential for further savings related to energy and water use, including sewer water reclamation.

31.48 Assessing air quality in New Delhi. The air quality in New Delhi is a significant problem and a serious concern and priority of the Mission. The World Health Organization described New Delhi as the fourth most polluted city in the world and the situation continues to worsen. We noted that the Mission has begun to gather data in order to analyze the quality of air in its facilities.

31.49 Minimizing energy

consumption in Geneva. Efforts have been made in Geneva to minimize energy consumption. The project's design brief called for the selection of equipment that minimized life cycle costs, for projected maintenance, and for energy consumption over the equipment's life. We noted that a superior heating and cooling system was installed that is expected to significantly reduce energy consumption. However, the Department could not quantify the level of expected energy savings at the time of our audit.

Improved tracking of costs and reporting is required

31.50 Good project management requires that all costs associated with the project be tracked and compared against budget. Accurate and timely reporting of budget variances allows decision makers to address any significant variance or exception. We found that all project costs were not being systematically tracked and

reported to senior management and to the Treasury Board as required by Treasury Board policies for managing capital projects. This issue is of particular importance in the case of projects that consume significant internal resources over long periods of time, such as the New Delhi chancery expansion project that extended over a period of 15 years.

31.51 Using departmental estimates where available, we calculated that the cost of internal resources substantially dedicated to the New Delhi chancery expansion and staff quarters project totalled at least \$800,000 and \$560,000 respectively, excluding the cost of related travel and other out-of-pocket expenses. A similar calculation for the planned Seoul project resulted in a figure of \$522,000. The Department could not provide us with the estimates for the Bangkok and Geneva projects.

31.52 With respect to the Geneva project, we found that the Bureau was in the process of establishing separate projects for landscaping and the purchase of additional land at a total estimated cost of \$500,000. In our opinion, these activities are directly related to the new Chancery and their cost should be charged to the project.

31.53 We noted several weaknesses in the reporting of project performance to senior management. Reports that monitor project progress (scope, cost and schedule) against plans were not produced on a regular basis. Officials told us that project completion and evaluation reports are seldom produced in a timely manner due to lack of resources. Bureau management relies primarily on meetings and discussions with officials and on a weekly review of the Long-Term Capital Plan monthly cash flow reports to keep apprised of the status of projects. There is also a view within the Department that capital projects do not receive sufficient attention by senior management. We believe that formal reporting and review

We are concerned about the accuracy and completeness of statements in various Treasury Board submissions.

practices would result in better project management.

31.54 The Physical Resources Bureau should track and allocate all costs specifically identifiable with a particular project. The Bureau should prepare reports that monitor project progress (scope, cost and schedule) against plans to allow decision makers to address any significant variance or exception.

Inconsistent compliance with Treasury Board policies is a concern

31.55 We noted two instances where the Department had exceeded its delegated authority and Treasury Board approval was granted retroactively. In one instance, the Department signed a three-year lease at an annual rent of \$785,000 prior to seeking Treasury Board approval. In addition, a \$400,000 deposit was made by the Mission to the landlord before the lease was signed. However, in seeking retroactive approval to enter into the lease, the Department did not inform the Treasury Board of the \$400,000 payment.

31.56 In a second instance, the Department had amended a consultant agreement by \$2.4 million without prior Treasury Board approval.

31.57 Finally, as illustrated by the case study below and as also noted in paragraph 31.30, we are concerned about the accuracy and completeness of statements in various Treasury Board submissions, such as those justifying project budget increases; they appear to be inconsistent with our audit evidence.

31.58 The Department of Foreign Affairs and International Trade should ensure consistent compliance with its delegated authorities.

Recent internal audits of three capital projects have identified concerns about project management practices

31.59 The Department's Inspector General recently issued draft reports on the audit of three capital projects: Algiers Diplomatic Complex, New York Consulate General lease fit-up, and Canada House refurbishment in London. A draft summary report of all three projects was also issued. At the end of our audit, the reports had not yet been finalized. Accordingly, we were not able to formally review the reports and supporting working papers and therefore could not determine the extent to which we could rely on the work. However, based on our discussions with the Inspector General's Office, we noted that its findings are similar to the issues and observations raised in this chapter.

Inaccurate and Incomplete Reporting to the Treasury Board

In August 1994, the Department obtained Treasury Board approval to design and construct a diplomatic complex (chancery plus staff quarters) in Seoul, South Korea at an estimated cost of \$33.6 million. The project was expected to be completed by December 1997. In August 1997, the Department informed the Treasury Board that the estimated project cost had increased to \$55.2 million, with a target occupancy date of June 2000. The increase was attributed to a combination of inadequate information on Korean construction costs at the time, the failure to include the payment of value-added tax as a project cost, and inflation in the Korean construction market. The Department maintained that the only real test of cost is the marketplace, and the tendered cost of the acceptable proposal exceeded the generic cost estimate.

As noted previously, we found that the 1994 project cost estimate was incomplete and unreliable. The Department did not prepare a proper cost estimate until April 1996. In our view, poor estimation of project cost in 1994 was the primary reason for the need to increase the project budget in 1997. We also expected that the Department would have informed the Treasury Board as to the reason(s) for the 2.5 year project delay from December 1997 to June 2000.

Commissioning

Consistent commissioning practices will decrease project risk

31.60 Commissioning is a sequential method of testing and validating results against expected performance criteria for all building components and equipment, systems and integrated systems. We found that commissioning practices varied among several of the projects reviewed.

31.61 New Delhi chancery. Funds were allocated for commissioning in the project budget. Although a formal commissioning plan was not prepared, commissioning activities were appropriately carried out and we did not observe any significant problems. Users indicated that they are generally satisfied with the building's services.

31.62 Geneva chancery. We found that the project budget did not include funds to plan and carry out commissioning. In fact, a commissioning plan had not yet been prepared just days before the building was scheduled for substantial completion. We noted that four different commissioning officers had been involved with the project during the prior eight months. Without a sound commissioning plan and testing, the Department would not have independent assurance that the building's systems will function as intended. Also, there is a greater risk that deficiencies will not be identified prior to acceptance of the building. Project officials have recently informed us that a \$130,000 commissioning contract was awarded on 7 July 1999. Commissioning is expected to be completed by the end of October 1999.

31.63 The Department of Foreign Affairs and International Trade should ensure that projects are commissioned so that program requirements are satisfied with minimum cost and disruption.

Project Files

Project files are maintained in an ad hoc fashion and do not clearly demonstrate closure of issues

31.64 Well-organized and complete project files support effective project management. This is particularly important for the Department of Foreign Affairs and International Trade as it manages projects around the world. Separations of time, distance and foreign cultures, along with the rotational assignment of personnel, underscores the importance of maintaining proper files, which avoids unnecessary revisit of issues previously studied and analyzed. We noted that project files are generally maintained in an ad hoc fashion and do not fully and easily capture important decisions and conclusions. In particular, we are concerned that project files do not clearly indicate the resolution of issues.

31.65 In Bangkok, departmental officials expressed concerns over a lease signed in 1995 relating to fixtures and furniture for the official residence. During our field visit, we noted that the project files did not indicate whether these concerns had been addressed. In the case of the New Delhi official residence, various options had been presented and discussed for the development of this site prior to the recent renovation. However, we noted that important information supporting the decision was not documented in the project files.

Conclusion

The projects were successfully implemented, but better planning and analysis of options are required

31.66 Our audit findings and observations relate only to the projects examined. Although the findings seem to point to some systemic planning weaknesses that should be investigated by management, we did not audit the

Physical Resources Bureau, the Geographic Branches or the missions in their entirety. We conclude that the facilities meet the users' stated requirements. Officials at the missions we visited generally expressed a high level of satisfaction with their new accommodation. They believe that the facilities enable them to better deliver their programs and have improved staff morale. Overall, the projects were delivered within approved budgets and project schedules. We also noted several positive initiatives to address environmental concerns.

31.67 Capital projects commit the Crown to large one-time capital expenditures and often to even greater ongoing operating and maintenance costs over the life of the asset. It is therefore crucial that reliable estimates of the projects' total costs be provided to senior management and the Treasury Board before the projects become committed. It is equally important that all reasonable options for significant cost savings be explored and reported to senior management and the Treasury Board. We noted weaknesses in both these areas.

31.68 The quality of analysis and documentation used to support investment decisions fell short of that required by the Department's own policies and established methodologies for managing capital projects. The Physical Resources Bureau needs to further improve the way it tracks and reports project costs and budget variances. In addition, we noted two instances in which the Department had exceeded its delegated contracting authority and the Treasury Board approval was granted retroactively. Recent internal audits of three capital projects have

identified similar concerns about the Department's project management practices. In our opinion, all of the above-noted factors may have resulted in additional costs ranging from at least \$8 million to \$15 million over a 20-year period.

31.69 The Physical Resources Bureau has taken initiatives in the past few years to improve its project management systems and practices. We would expect that the Bureau would take into account in its management improvement initiatives the concerns raised by this audit as well as those raised by the Department's Office of the Inspector General. We also encourage the Inspector General to continue to give priority to this aspect of the Department's operations. We plan to monitor future projects delivered by the Physical Resources Bureau and report to Parliament, as appropriate.

***Department's overall response:** The Department agrees with the Auditor General's recommendations. Project delivery performance has focussed on ensuring that projects are viable and justified based on final cost estimates prior to proceeding. However, preliminary cost estimates have sometimes failed to predict the evolution of program requirements, or market forces during subsequent project planning stages.*

The Department will continue to re-evaluate the rationale for capital projects whenever cost estimates change and, as in the case of Seoul, whenever indicated by volatile local property markets.

Project documentation, investment analysis, and reporting to the Treasury Board will continue to be improved.

We conclude that the facilities meet the users' stated requirements.



About the Audit

Objectives

The objectives of the audit were to determine whether the selected facilities meet the clients' requirements and Treasury Board approvals, and whether they were planned and implemented with due regard to economy and efficiency, taking into account environmental considerations.

Scope

We examined the major aspects of the selected projects from the perspective of generally accepted practices of good project planning and implementation. Specifically, we reviewed the needs definition and statement of requirements, options analysis, project definition and approval, design and contracting, construction and commissioning phases, as appropriate. Our review of departmental program issues was limited to obtaining a general understanding of the program requirements that the new facilities were designed to meet. Except for their role in the projects examined, we did not audit the Physical Resources Bureau, the Geographic Branches or the missions. The commissioning phase for the Geneva chancery had not been completed by the end of our field work.

Criteria

Our audit criteria were derived from the established methodologies of the Office of the Auditor General for auditing capital asset projects and from the Treasury Board policies for managing capital projects. We also took into account the Physical Resources Bureau's Project Delivery System that elaborates on Treasury Board policies for managing capital projects.

Approach

We interviewed most of the key departmental program and project officials and reviewed relevant project files and documents. Our fieldwork included site visits to all of the projects. During our site visits, we also looked at several projects completed for other countries.

Audit Team

Assistant Auditor General: Shahid Minto
Director: Joe Martire

Rodney Newcombe
Elizabeth Fox

For information, please contact Joe Martire.

The Department of Foreign Affairs and International Trade provided the following action plan in response to our recommendations.

THE DEPARTMENT'S ACTION PLAN

The Department will continue its ongoing improvements to the Property Program, including measures to address issues raised by the Auditor General.

- **The analysis of property options, and estimation of future projects costs, will be further improved:**
 - The practice, begun in 1996, of contracting with internationally experienced quantity surveyors to obtain independent project cost estimates will be continued.
 - In November 1999, the Department will call for expressions of interest to provide cost estimation services through standing offers.
 - Implementation of the recommendations in the March 1999 independent review of the investment analysis methodology will be continued.
 - In January 2000, the Department will complete its revised guidelines for conducting feasibility studies.
- **The Department will examine methods for calculating and reporting the overhead costs of project administration.**
- **Best practices for reporting of project performance and documentation will continue to be introduced:**
 - In February 1999, electronic project files were established for new projects.
 - In late 1999, the “Project Systems” module in the Department’s new integrated financial management system will be implemented.
- **An updated guide to Treasury Board contracting and financial authorities will be disseminated within the Department, and progress on the Action Plan will be reported to the Treasury Board in 2000.**

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This November 1999 Report comprises 14 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and November 1999 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 32

**Follow-up of Recommendations
in Previous Reports**

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Follow-up of Recommendations in Previous Reports

Main Points

32.1 The majority of our reviews this year depict an improvement in the efforts made by management to take positive and effective remedial action. In other cases, we are concerned with the slow progress on fixing the problems — for a variety of reasons, as outlined in the various segments.

32.2 The Department of Finance has gone to considerable effort in trying to address and resolve the issues we raised in our 1997 chapter about its equalization program. The changes enacted through Bill C-65 had a significant financial impact on the federal government and resulted in payments being more consistent with the principles of the program.

32.3 At Human Resources Development Canada, the Department expended considerable effort to improve service to clients and manage the Canada Pension Plan Disability program more effectively. It took action in each area discussed in our 1996 chapter.

32.4 The RCMP Public Complaints Commission has undertaken initiatives to address our previous audit concerns about reducing its backlog of cases and streamlining its complaint review procedures. However, it needs to further reduce its backlog, develop a communications strategy, restructure its information system and work with the RCMP to meet its review turnaround target.

32.5 Our follow-up of Canada's Export Promotion activities found that Industry Canada and Foreign Affairs and International Trade have made significant progress on many operational matters; however, progress is much less evident in areas that would improve accountability for results. As well, Foreign Affairs and International Trade advised the Standing Committee on Public Accounts that it would propose a realistic and feasible service charging scheme, but the departments have decided not to implement charging for services. While the departments believe that the measures they have taken are sufficient, we are concerned that the progress we have observed will not be sustained if our other recommendations are not implemented.

32.6 In our follow-up of financial management and control at Foreign Affairs and International Trade, we noted a lack of urgency in implementing a number of our recommendations; however, where the Department had focussed its efforts, it had made considerable improvements.

32.7 The Treasury Board Secretariat has taken certain steps to respond to our recommendations on Renewing Government Services Using Information Technology. The Secretariat has made good progress in its monitoring and measurement of government-wide information management and information technology initiatives. However, progress over the past three years has been slow and, to date, full implementation of action to address our recommendations has been limited.

32.8 A number of the original chapters were reviewed by the Standing Committee on Public Accounts. We feel that this has been instrumental in bringing about necessary changes.

Introduction

32.9 It is our policy to make recommendations in all of our audits that are oriented toward correcting current or future problems and improving the management of government. We encourage management of the entities that we audit to respond to us in writing, stating whether they agree with our recommendations, and how they plan to implement corrective action. We, in turn, publish their responses in our report, so that Parliament and the public will be able to judge their commitment.

32.10 Although some recommendations can take several years to implement, our general policy is to follow up progress after two years, unless there is a good reason to follow up on some different basis. Each year, we provide a running list of previous chapters that tracks the status of our follow-up activity for those segments that are not included in this chapter. Exhibit 32.1 provides the list of chapters due for follow-up, but not included in this chapter.

32.11 It is important for readers to understand what a follow-up is, and is not. Apart from a few unique situations, it is not a second audit of the same issues. Rather, it is a report on what management tells us, or can demonstrate to us, about the progress it has made toward meeting our recommendations since our initial report on the subject. We do not exhaustively seek or examine additional evidence to support or refute what management has told us, but we do review its claims for reasonableness and report to Parliament accordingly.

32.12 In our 1999 Report, we review progress made by entities in response to recommendations contained in 23 previous chapters. This chapter contains the results of our review of 11 of these chapters. The others are reviewed in individual chapters of our April, September and November volumes of the 1999 Report.

32.13 In a marked change from previous years, the majority of our reviews this year depict an improvement in the efforts made by management to take positive and effective remedial action. Getting departments to undertake improvements is not easy, but through our recommendations and the interest shown by the Public Accounts Committee we are seeing progress. Examples where considerable effort has resulted in changes being made include Human Resources Development Canada — Canada Pension Plan: Disability, and the Department of Finance — Equalization Program.

32.14 In other cases, we are concerned with the slow progress on fixing the problems — for a variety of reasons, as outlined in the various segments. Examples where we note some encouraging developments but feel that greater effort is required include Indian and Northern Affairs Canada — Funding Arrangements for First Nations — 1996, Chapter 13 (reported in Chapter 10 in our April 1999 Report), and Foreign Affairs and International Trade — Financial Management and Control.

32.15 The Indian and Northern Affairs Canada follow-up chapter in our April 1999 Report was subsequently reviewed by the Public Accounts Committee. We believe that the Committee's continued interest in this area has acted as a positive catalyst, resulting in a specific commitment to action to address our 1996 recommendations. In fact, we feel that the Committee has, through its reports to the House, contributed to changes in a number of important areas.

32.16 Because this is a follow-up of actions taken on previous recommendations, we do not normally make new ones. However, in the segment Renewing Government Services Using Information Technology, our review indicated a need for a follow-up recommendation due to changed circumstances.

Follow-up of Recommendations in Previous Reports

Exhibit 32.1

Other Chapters Due for Follow-up

Year and Chapter	Chapter Title	Responsible Auditor	Follow-up Status
1993			
22	Department of Transport – Airport Transfers	Hugh McRoberts	Deferred from 1995 as no further transfers had been made to airport authorities. To be included in a new chapter, planned to report in 2000.
1994			
9	Science and Technology – Overall Management of Science and Technology Activities	Richard Flageole	These audits are being followed up in a phased approach: <ul style="list-style-type: none"> • Government-wide issues related to the management of research activities and scientific personnel were followed up in Chapter 15 of our 1996 Report and Chapter 22 of our 1998 Report. • Issues at the departmental level will be included in future audits.
10	Science and Technology – Management of Departmental Science and Technology Activities	Richard Flageole	
11	Science and Technology – The Management of Scientific Personnel in Federal Research Establishments	Jacques Goyer	<ul style="list-style-type: none"> • Our follow-up work dealing with the “Framework for the Human Resource Management of the Federal Scientific and Technical Community” is reported in Chapter 9 of the April 1999 Report.
12	Aspects of Federal Real Property Management	Reno Cyr	Reported in Chapter 18 of our September 1999 Report.
18	Correctional Service Canada – Supervision of Released Offenders	David Brittain	Reported in Chapter 1 of our April 1999 Report.
34	Public Works and Government Services Canada – Management and Operation of Crown-Owned Office Buildings	Michael Weir	Reported in Chapter 18 of our September 1999 Report.
1995			
5	Office of the Superintendent of Financial Institutions – Deposit-Taking Institutions Sector	Beant Barewal	Deferred. Planned to be combined with a follow-up of Chapter 30 of the 1997 Report reporting in 2000.
10	Crown Corporations – Fulfilling Responsibilities for Governance	Grant Wilson	Portions of the chapter are being followed up in a phased approach: <ul style="list-style-type: none"> • Performance measurement was followed up in Chapter 22 of the December 1997 Report. • Further follow-up on special examinations is planned to report in 2000.
24	Revolving Funds in the Parliamentary System – Financial Management, Accountability and Audit	Michael Weir	Deferred. Planned to report in 2000.
1996			
3	Evaluation in the Federal Government	Stan Divorski	Deferred. Planned to be combined with an audit of performance reporting to Parliament reporting in 2000.
5	Reform of Classification and Job Evaluation in the Public Service	Jacques Goyer	Deferred. Planned to report in 2000.

Exhibit 32.1 (Cont'd)

Year and Chapter	Chapter Title	Responsible Auditor	Follow-up Status
8	CSIS – National Headquarters Building Project	Reno Cyr	Deferred. Planned to be combined with a follow-up of Chapter 7 from our April 1998 Report reporting in 2000.
10	Correctional Service Canada – Rehabilitation Programs for Offenders	David Brittain	Reported in Chapter 1 of our April 1999 Report.
14	Service Quality	Theresa Duk	Deferred. Planned to be combined with an audit of this area reporting in 2000.
19	Revenue Canada – Child Tax Benefit and Goods and Services Tax Credit Programs	Basia Ruta	Deferred. Planned to be combined with an audit of this area reporting in 2002.
26	Canada Infrastructure Works Program: Lessons Learned	Henno Moenting	Reported in Chapter 17 of our September 1999 Report.
30	Correctional Service Canada – Reintegration of Offenders	David Brittain	Reported in Chapter 1 of our April 1999 Report.
33	Indian and Northern Affairs Canada – Funding Arrangements for First Nations	Grant Wilson	Reported in Chapter 10 of our April 1999 Report.
34	National Defence – Support Productivity	Peter Kasurak	Deferred. The original chapter looked at the Department of National Defence mid-way through its renewal process. A follow-up audit will be conducted after the renewal process is complete and is planned to report in 2000.
1997			
1	Maintaining a Competent and Efficient Public Service	Otto Brodtrick	There will be no follow-up of Chapter 1. It was a study and contained no recommendations.
2	Financial Management: Developing a Capability Model	Hugh McRoberts	Chapter 2 was a study and contained no recommendations. An audit of this area is planned to report in 2000.
3	Management of the Government's Accounting Function: A Central Agency Perspective	John Hodgins	Included in Chapter 21 of this Report.
4	Control of the Transboundary Movement of Hazardous Waste	Wayne Cluskey Dan Rubenstein	Deferred. Planned to be included in the Commissioner of the Environment and Sustainable Development Report in 2000.
5	Reporting Performance in the Expenditure Management System	John Mayne	Deferred. Planned to be included with an audit of this area reporting in 2000.
6	Contracting Performance	Michael Weir	There will be no separate follow-up of this chapter. Issues raised in the chapter are included in Chapter 30 of this Report and are planned to be included in future audits of this area.
10	Natural Resources Canada – Energy Efficiency	Ellen Shillabeer	Deferred. Planned to be included in the Commissioner of the Environment and Sustainable Development Report in 2001.
11	Moving Toward Managing for Results	John Mayne	Chapter 11 was a study and contained no recommendations. Issues raised in this chapter will be included in an audit planned to report in 2000.
12	Information Technology: Preparedness for Year 2000	Nancy Cheng	Included in Chapter 25 of this Report.

Exhibit 32.1 (Cont'd)

Year and Chapter	Chapter Title	Responsible Auditor	Follow-up Status
13	Health Canada – First Nations Health	Ronnie Campbell	Deferred. Planned to report in 2000.
14	Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish	Doug Timmins	Deferred. Planned to report in 2000.
15	Fisheries and Oceans Canada – Rationalization and Renewal: Atlantic Groundfish	John O'Brien	Deferred. Planned to report in 2000.
16	Human Resources Development Canada – The Atlantic Groundfish Strategy	Louis Lalonde	Reported in Chapter 8 of our April 1999 Report.
17	Human Resources Development Canada – A Critical Transition Toward Results-Based Management	Louis Lalonde	Deferred. Planned to report in 2000.
18	Revenue Canada and Department of Finance – Fostering Improvement in Tax and Trade Administration: Follow-up of Previous Audits	Jim Ralston	There will be no separate follow-up of this chapter. It was a follow-up of previous work.
19	Transport Canada – The Commercialization of the Air Navigation System	Hugh McRoberts	There will be no separate follow-up of these chapters. Issues raised in the chapters are planned to be included in future audits if significant privatization occurs.
20	Public Works and Government Services Canada – Privatization of the Canada Communications Group	Alain Boucher	
22	Crown Corporations: Making Performance Measurement Work	Pierre Serré / Grant Wilson	There will be no separate follow-up of Chapter 22. It was a study and contained no recommendations.
25	Citizenship and Immigration Canada and Immigration and Refugee Board – The Processing of Refugee Claims	Serge Gaudet	Deferred. Planned to report in 2000.
26	Canada Labour Relations Board	Alan Gilmore	Deferred. Planned to report in 2000.
27	Ozone Layer Protection – The Unfinished Journey	Wayne Cluskey	Deferred. Planned to be included in the Commissioner of the Environment and Sustainable Development Report in 2000.
28	Fisheries and Oceans Canada – Pacific Salmon: Sustainability of the Resource Base	John McCullough	Reported in Chapter 20 of this Report.
29	Industry Canada – Management of the Small Business Loans Program	Harry Ruthnum	This program, including its governing legislation, has changed significantly. As a result, there will be no separate follow-up of this chapter.
30	Office of the Superintendent of Financial Institutions – Insurance and Pensions	Crystal Pace	Deferred. Planned to be combined with a follow-up of Chapter 5 of the 1995 Report reporting in 2000.
31	Revenue Canada – The Financial Management Regime	Basia Ruta	Issues raised during the audit are planned to be included in future audits of the planned Revenue Agency.
32	Revenue Canada and Department of Finance – Understanding Changes in Tax Revenues: GST	Scott Milne Jim Ralston	Deferred. Planned to report in 2000.

Treasury Board Secretariat — Renewing Government Services Using Information Technology — 1996, Chapter 16

*Assistant Auditor General: Doug Timmins
Principal: Nancy Cheng*

Background

32.17 In our 1996 audit of the Treasury Board Secretariat, we reported on selected components of two major initiatives of the Chief Information Officer (CIO) Branch involving the use of information technology to renew government services.

32.18 We made several observations and recommendations concerning the development of a government-wide electronic infrastructure and the move toward shared administrative systems as key initiatives in service renewal. In support of the government's implementation of its technology document entitled "Blueprint for Renewing Government Services Using Information Technology", we also recommended that the Secretariat track policy implementation and assess results against government-wide objectives.

Scope

32.19 Our 1999 follow-up work involved reviewing the Secretariat's status report on progress in implementing the recommendations. Our observations are based on interviews with Secretariat officials and a review of documents provided to us, including the changes to the Secretariat's strategic directions, objectives and policies for government-wide information technology initiatives.

Conclusion

32.20 The follow-up showed that the Secretariat has taken certain steps to respond to the recommendations.

However, the progress over the past three years has been slow and, to date, full implementation of action to address our observations and recommendations with visible results has been limited. This is in part due to a change in priority that the Secretariat made to address the Year 2000 computer problem on a government-wide basis. Nevertheless, development and action taken in recent months to advance a government-wide information management and information technology (IM/IT) infrastructure are encouraging and they have provided a positive environment to support its implementation.

Observations

Government-wide electronic infrastructure

32.21 **Government-wide network management.** In 1996, we recommended that the Secretariat ensure that government-wide network management be developed and implemented on a more timely basis to support interoperability for program and administrative service renewal across government.

32.22 In the follow-up, we found that progress continued to be slow on moving toward common network management services. The cluster network arrangement endorsed in 1995 by Treasury Board ministers was abandoned soon after completion of the 1996 audit. Although the Secretariat advised us in the 1996 audit that it was in the process of defining and articulating a future vision of a common network infrastructure, the follow-up showed little progress in its formulation, despite the continuing and

Recent development and action to advance a government-wide information management and information technology infrastructure are encouraging.

growing need for government-wide interoperability.

32.23 The situation has improved since early this year. In April 1999, the Secretariat put forward plans for a government-wide strategic IM/IT infrastructure and received endorsement from Treasury Board ministers. The proposed infrastructure included a strategic framework for implementing a common IM/IT infrastructure, a governance framework, a network strategy and procurement approach for telecommunications and initial funding to begin its implementation.

32.24 Implementing such an infrastructure can prove to be a real challenge. In this current effort, there are a number of existing factors that should facilitate successful implementation. The major factors include the following:

- **Presence of a business driver.** The desire for putting in place a common IM/IT infrastructure is driven by program needs to support an electronic and more integrated delivery of government services.

- **Acceptance of the proposed architecture.** The proposed federated architecture, developed under the direction of the CIO Branch, was accepted by senior management across major departments and agencies.

- **Identification of initial projects.**

Four domains of logically grouped technologies have been identified as initial projects to serve as building blocks for the progressive implementation of the common infrastructure.

- **Recognition of funding needs.** The need for ongoing central funding to support the common government-wide components of the IM/IT infrastructure has been recognized and initial funding was approved to start the implementation.

32.25 Government-wide network management has been identified as an

initial project to move forward. The CIO Branch, in partnership with other major departments, plans to seek approval from Treasury Board ministers in late fall 1999 for ongoing funding to support the IM/IT infrastructure initiative.

32.26 Information technology standards.

A critical element of ensuring a government-wide IM/IT infrastructure is to adopt and comply with standards that permit various components to communicate and interoperate. In the 1996 audit, we noted that the implementation plan for the refocussed Treasury Board Information Technology (TBIT) standards program that was endorsed by Treasury Board ministers remained at the policy level. This continued to be the case in our follow-up, with little progress being made in the adoption of standards to ensure interoperability. The few standards initiatives that have been undertaken in the past three years were instigated mostly by departments and not by the Secretariat staff that were responsible for the TBIT standards program.

32.27 The adoption of the current IM/IT infrastructure initiative provides an opportunity to address the TBIT standards issue. Standards are an integral part of the implementation framework. There is also a proposed governance framework involving an Architecture Review Board that can oversee the adoption of and compliance with standards.

32.28 With respect to monitoring for compliance with the TBIT standards, we found some evidence at a high level for large projects requiring Treasury Board approval. For example, the Secretariat placed limitations on the acquisition of long-term telecommunication services until such time that it completed a review of the management and governance of government-wide telecommunication services.

32.29 Management of technology funds.

In 1996, we examined the management of two technology funds —

Little progress has been made in the adoption of standards to ensure interoperability.

the Informatics Partnership Fund and the Informatics Infrastructure Fund. We concluded that lessons can be learned from the experience and applied in administering other technology funds to maximize the benefits of using information technology in government.

32.30 Subsequent to the audit, the Informatics Partnership Fund ended but no reviews were conducted of individual projects to promote knowledge sharing, although that was a general criterion of that Fund. The Informatics Infrastructure Fund ended during 1999–2000, with funding of \$41 million provided to 18 projects. A review was initiated to evaluate those projects against their objectives but it was not completed.

32.31 In addition, we commented in 1996 on a lack of clarity in the terms and conditions for the Informatics Infrastructure Fund. At that time, the Secretariat indicated that it was reviewing

the terms and conditions of the Fund, in particular the payback condition, which was the main point of contention. During the follow-up, we found that, although some work had been initiated by the CIO Branch, the terms and conditions of the Fund were never amended. Only one in 18 initiatives that were awarded funding was required to pay back the loan in accordance with the stated terms and conditions of the Fund.

32.32 In our view, the lack of clarity in the terms and conditions of the Informatics Infrastructure Fund continued to limit its effectiveness as an investment vehicle for government-wide infrastructure initiatives. The \$60 million budget was to span over four years. Even with an extension to five years, only \$41 million was used (see Exhibit 32.2). Moreover, while the Fund was intended for use by all departments and agencies to move toward a government-wide infrastructure, the prime user of the Fund

\$ Millions

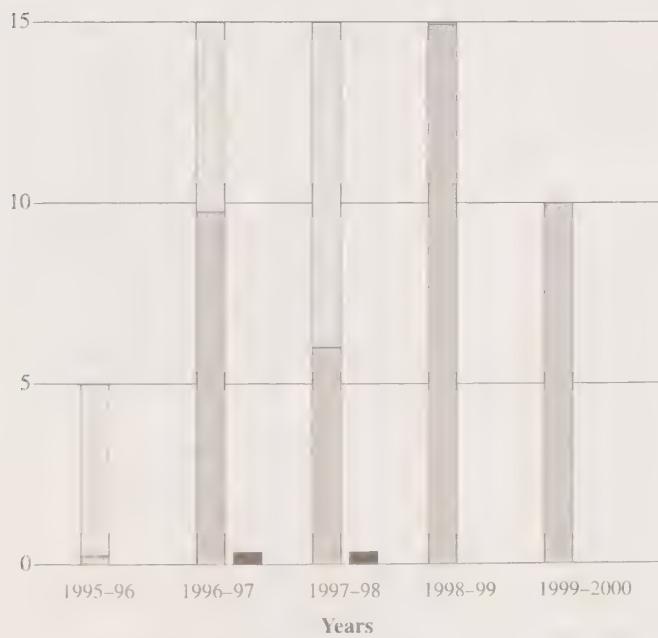
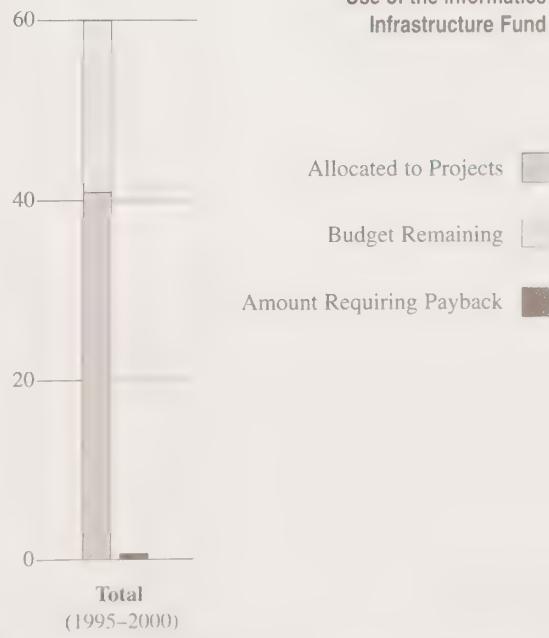


Exhibit 32.2

Use of the Informatics Infrastructure Fund



Note: In 1995–96, \$10 million was re-profiled to 1999–2000, thus extending the original life of the Informatics Infrastructure Fund by one year.

Source: Treasury Board Secretariat

The Shared System review recommended that the Secretariat provide more active leadership.

was the Treasury Board Secretariat. Fifteen of eighteen initiatives that received funding originated from the Secretariat.

Shared Systems Initiative

32.33 Defining targets and results. In order to define targets and results, we observed in 1996 that there was a need for a better method to estimate and compare the costs of acquisition, implementation and ongoing maintenance of shared systems with those of the existing systems across government.

32.34 In 1999, the CIO Branch conducted a review of the Shared Systems initiative to determine its success to date and to identify any remedial action required of the Secretariat and the participants. The review identified the need for business cases by departments that would include full costing for the individual shared system. It did not specifically address the issue of costs.

32.35 In briefing major cluster groups of various shared systems, the Secretariat indicated that it would develop criteria by which the effectiveness of shared systems will be measured. It also suggested that the performance of the Shared Systems initiative be reviewed annually by an oversight group under a newly constituted Information Management Board.

32.36 Shared accountability. In 1996, we observed that a new management framework, called the “shared accountability triad”, carried risks that could undermine the benefits of the Shared Systems initiative. In our Report, we recommended that the Secretariat continue to provide a leadership role by retaining oversight, monitoring progress, and taking joint action with departments, as appropriate, to further the interest of the government as a whole.

32.37 In seeking endorsement and funding support for the Shared Systems initiative, the Secretariat defined its role

as providing leadership, policy, and strategic and operational direction to cluster groups of various shared systems. The draft report for the 1999 Shared Systems review showed that the Secretariat has not fulfilled this role. The review recommended that the CIO Branch be re-established as the champion for the initiative and that it create a Shared Systems management function that would be responsible for strategic planning, policy and co-ordination of functional domain activities and issues. It further recommended that the functional heads within the Secretariat provide more active leadership by communicating and planning their policy changes with the corresponding cluster groups.

32.38 In early August 1999, the CIO Branch was finalizing the report for the Shared Systems review. The findings have been shared with major cluster groups of various systems and the Branch has developed an initial plan to respond to the issues raised in the review.

32.39 The Treasury Board Secretariat should finalize the report for its Shared Systems review, complete its action plan and implement the plan on a timely basis in order to benefit ongoing cluster groups of existing shared systems and any new shared systems domains. In particular, the Secretariat should develop and put in place a governance and accountability structure that will provide cluster groups of the various shared systems with strategic and business planning at a corporate level, monitor the overall performance of initiatives and facilitate ongoing investments.

Treasury Board Secretariat response: The Shared Systems review provided the Treasury Board Secretariat and government departments with a comprehensive assessment of the government-wide Shared Systems initiative. The findings and the subsequent recommendations will serve all stakeholders in restructuring and

refocussing this valuable government initiative. Having conducted extensive consultations in the government community, the report and action plan has been finalized. As detailed in the action plan, the Secretariat is currently working with departments in the restructuring of the governance, accountability and management frameworks that support the Shared Systems initiative. The action plan will help ensure that the government-wide investments in administrative systems are well managed and optimize the corporate investments of both individual departments and the government as a whole.

Implementing the technology Blueprint

32.40 Overcoming challenges. The implementation of the technology Blueprint was gaining momentum in 1996. However, we were concerned that the momentum would not be sustained if the Treasury Board Secretariat did not exercise its oversight role or continue to facilitate the implementation of various initiatives.

32.41 We found that the Secretariat has recently taken steps to establish an oversight body for its strategic IM/IT infrastructure initiative. In June 1999, the Secretariat put in place a governance structure with members from senior management across government. The Information Management Board (IMB), chaired by the CIO, has a mandate for making decisions and overseeing the adoption and implementation of a government-wide IM/IT infrastructure.

32.42 The Treasury Board Secretariat expects the IMB to review and endorse proposals that seek central funding for advancing a government-wide IM/IT infrastructure. The Secretariat proposes to adopt a benefits-driven approach for investment decisions related to initiatives for the government-wide IM/IT infrastructure. The Secretariat has

developed a draft set of value/benefit criteria to assess the various opportunities proposed by individual departments.

32.43 Tracking implementation at a strategic level and defining results relative to government-wide objectives. In 1996, we recommended that where policy and direction for the use of information technology have been set and promulgated, the Treasury Board Secretariat should track implementation at a strategic level to measure the results against government-wide objectives and take corrective action as appropriate.

32.44 We noted good progress in the Secretariat's approach to evaluating government-wide IM/IT initiatives.

32.45 The CIO Branch has become more proactive in analyzing and measuring the results of government-wide initiatives. For example, it completed a baseline study in 1998 to assess its Enhanced Management Framework used by departments in managing large IT development projects. In 1999, it commissioned the Shared Systems review. Since 1998, the CIO Branch has been monitoring and tracking Year 2000 progress for departmental systems that support government-wide mission-critical functions.

32.46 The Portfolio Management Division of the CIO Branch reviews departmental business plans to ensure that they are congruent with government-wide objectives and strategies for information management and information technology. Submissions to the Treasury Board that relate to IM/IT are reviewed for compliance with the Enhanced Management Framework to help departments and agencies meet budgets and time lines that they set. Departmental perspective documents, departmental management assessments and Memoranda to Cabinet are used as the basis for monitoring departmental performance in the IM/IT.

We noted good progress in the Secretariat's approach to evaluating government-wide information management and information technology initiatives.

Human Resources Development Canada — Canada Pension Plan — Disability — 1996, Chapter 17

*Assistant Auditor General: David Rattray
Principal: Louis Lalonde*

The Department has expended considerable effort to improve service to clients and manage the CPP Disability program more effectively.

Background

32.47 Chapter 17 of the 1996 Report of the Auditor General focussed on the management of the Disability component of the Canada Pension Plan (CPP). Observations and recommendations were made concerning the causes of the rapid growth in Disability benefit payments, management practices for assessing eligibility for Disability benefits, harmonization with other programs, and information on results.

Scope

32.48 Our follow-up consisted of a review of the progress reports prepared by Human Resources Development Canada (HRDC) on activities in response to our recommendations. We also reviewed departmental documents and held discussions with staff.

32.49 In addition, we examined random sample files to evaluate progress made by the Department in reassessing Disability files and estimating mispayments.

Conclusion

32.50 Following the release of our 1996 chapter, the Department developed an action plan and set up a number of committees and working groups to study and implement our recommendations. In April 1997 and 1998, the Department submitted a report to the Standing Committee on Public Accounts to report on the progress made.

32.51 We note that the Department has expended considerable effort to improve service to clients and manage the CPP Disability program more effectively. It took action in each area discussed in our 1996 chapter. The Department

completed implementation of certain recommendations and revised the applicable administrative policies and practices. Its work is not finished, however. Numerous initiatives are still under way and it is too early to determine whether the expected results will be achieved.

32.52 Since the Department has not completed implementation of all the initiatives undertaken in response to our recommendations, we recommend that it continue to apprise Parliament of its progress in the coming years.

Observations

The Department has implemented a trend analysis system but has not identified any early-warning indicators

32.53 The Department has made some progress in setting up a database and implementing a system for monitoring trends. The information contained in the database is used to monitor monthly trends. A report on noted changes is produced each year. The most recent report, dated November 1998, presented an analysis of changes that had occurred, especially in the number of beneficiaries, the number of applications received and approved, and the number of terminations. The report did not, however, clearly explain the causes of the changes noted in the total value of the Disability benefits paid.

32.54 The Department has not developed and implemented early-warning indicators to enable it to take action when it notes significant variations in Disability benefit data. Consequently, it is not in a position to react to changes that occur in the profile of existing and potential clientele.

32.55 The Department needs to be able to explain trends noted in the profile of its clientele and in Disability benefit expenditures and assess the consequences. To this end, it needs to not only measure changes, but also explain the causes of such changes.

The Department is close to meeting its actuarial expertise needs

32.56 The Department is planning to hire an actuary by the end of 1999. We believe that acquiring such actuarial expertise will considerably facilitate data collection, the analysis of discrepancies, and the sharing of operational and strategic information between the Department and the Chief Actuary of the Office of the Superintendent of Financial Institutions.

32.57 We have examined the latest version of the memorandum of understanding between the Department and the Chief Actuary of the Office of the Superintendent of Financial Institutions. In our view, the memorandum still does not clearly set out their respective roles and responsibilities regarding reliability and integrity of data used by the Chief Actuary for actuarial forecasts of CPP Disability benefits.

The Department is able to assess the costs of proposed legislative changes

32.58 In Chapter 17, we recommended that the Department assess the effect on Plan funding and benefits of any proposed amendments to the adjudication of applications for Disability benefits. Once the costs were estimated, it would be possible for the Department to determine whether the amendment should be reflected in a guideline or in the Act.

32.59 The Department, in collaboration with the Office of the Superintendent of the Financial Institutions, has developed a simulation model, Dynacan, by which to estimate and assess costs of proposed legislative changes. This model could be

used to compare projected costs with current costs.

The Department has taken significant steps to improve its management information

32.60 The Department now gathers and produces more management information, but it has not yet implemented all of the mechanisms for analyzing the information and using it to manage the Disability program.

32.61 For example, the Department now knows the total costs of administering the benefits, but it is not yet able to determine the full cost of processing an initial application for Disability benefits, including costs associated with appeal procedures. Moreover, although the Department compiles data on grant and denial rates for Disability benefit applications, it has not yet analyzed trends or their causes.

32.62 The Department has begun developing a Management Information Framework that will incorporate many of the currently collected measurements and identify any remaining gaps in key information needs. The Department needs to give priority to the completion of the Framework and use the information to understand changes and to manage performance.

A quality assurance program is being implemented to assess the adjudication of applications for Disability benefits

32.63 The Department is developing and implementing a quality assurance program to assess the quality and consistency of Disability adjudication decisions, as well as causes and rates of error. The quality assurance program will assess each stream of the administrative process for adjudicating applications for Disability benefits: Initial Decisions and Reconsideration, Reassessments, and Appeals to a Review Tribunal. The initiative will be implemented by regional

Although the Department compiles data on grant and denial rates for Disability benefit applications, it has not yet analyzed trends or their causes.

quality assurance advisors who work independently of the Disability adjudication process.

32.64 The Department has been assessing the quality of Initial Decisions and Reconsideration in two regions since September–October 1999. It plans to extend the initiative to the other regions in March 2000. Development of the program for the other streams of the administrative process began in September 1999. Testing is expected to take place in July 2000. According to the proposed timetable, performance reports for the quality assurance program will not be ready until April 2001. However, management reports could be available as early as September 2000.

32.65 We have reviewed the Department's plans for the development and implementation of its quality assurance program. The plans appear reasonable. We urge the Department to rigorously adhere to them.

Management of reassessment activities has improved significantly but the Department needs to continue its efforts

32.66 In 1996, we indicated in our chapter that the Department did not conduct sufficient reassessments of Disability files and that it should more clearly flag cases to be reviewed.

32.67 The Department has significantly increased the number of reassessments since 1996. In the past three years, it has conducted 36,600 reassessments of Disability cases and terminated benefits in 8,300 cases. According to the data for the last three years, the Department reassesses the files of approximately four percent of the Disability benefit beneficiary population each year. An analysis of cease rates, by type of reassessment conducted, indicates that the Department is doing well in its selection of files for reassessment and gives priority to cases that have the highest probability of no longer being eligible for benefits.

32.68 The Department has advised us that the effort to decentralize the reassessment work in the regions will result in a temporary reduction in the number of reassessments conducted. Experienced assessors will have to devote time to training their colleagues in the regions, which means that they will have that much less time to conduct reassessments. As a result, the Department expects to be able to conduct only 8,000 reassessments in 1999–2000. We have further noted that the number of reassessments has declined in each of the last three years, dropping from 14,000 in 1996–1997 to 11,800 in 1997–1998, then to 10,700 in 1998–1999.

32.69 We acknowledge that the Department's current efforts to regionalize reassessment are an investment in the long-term success of the reassessment program. Nevertheless, we urge the Department to not allow too great a decline in the number of reassessments conducted each year; this will help the Department to ensure that it can identify, within a reasonable period of time, those beneficiaries who are no longer eligible for benefits, and to avoid a major backlog of work.

The procedures used to estimate mispayments now meet our requirements

32.70 In 1996, we indicated that the procedures used by the Department for estimating pension and benefit mispayments, particularly Disability benefit overpayments, made it impossible to present the situation fairly.

32.71 The Department has since revised its procedures in this area. Its review of the files selected has improved and its handling of overpayments identified in the samples is appropriate. Officers medically review most of the Disability files in the samples. Where a file was put into pay during the year being sampled, the initial decision is reviewed. Moreover, clear rules have been established for deciding

According to the data for the last three years, the Department reassesses the files of approximately four percent of the Disability benefit beneficiary population each year.

whether a mispayment should or should not be considered in calculating the total estimated value of mispayments in the population sample.

32.72 As a result of these changes, the Department is now able to provide more realistic estimates of mispayments. For example, the study based on the payments made in 1996 is nearing completion. On the basis of this study, the Department estimates that the most likely value of undetected mispayments for 1996 is \$60 million. A similar study relating to payments made in 1994 had resulted in an estimate of mispayments of only \$26 million. Specifically, Disability benefit overpayments for 1996 were estimated at \$29 million, compared with \$14 million for 1994.

32.73 In our view, the discrepancy between the above-noted amounts is not a reflection of a higher incidence of mispayments in 1996 than in 1994. Rather, it is the result of the improved procedures used by the Department to estimate mispayments.

Some measures have been taken to implement a vocational rehabilitation program but progress is slow

32.74 The Department has designed a vocational rehabilitation program that became a permanent component of CPP Disability in 1997–98. The services include skill or interest assessment, career guidance, and training and selective placement designed to help a disabled person secure and retain suitable employment. Under the supervision of CPP case managers, private sector contractors in the client's home region now deliver the services.

32.75 Considerable attention has been given to designing a program that will maximize the success of individual clients who are identified as ready for vocational rehabilitation. According to the Department, preliminary results indicate that 26 percent of clients who participated

in the program in 1998–99 returned to work. Currently, some 300 clients are participating in the vocational rehabilitation program. This is an increase of more than 100 percent over the previous year, the first full year of regionalized program delivery.

32.76 Although most beneficiaries cannot return to work due to the nature of their severely disabling medical conditions, the Department recognizes that many individuals with a disability want to work or to do volunteer work. The Department is currently studying other ways to encourage these individuals to take an active role in the work force.

32.77 We urge the Department to continue its efforts to implement measures to assist those CPP Disability beneficiaries with demonstrated potential to reintegrate into regular work life.

The exchange of information with the main stakeholders has begun

32.78 In order to better understand the profile and characteristics of co-beneficiaries of CPP Disability, workers compensation and private insurers, and to enter into exchange-of-information agreements with stakeholders, we recommended that the Department pursue methods of integrating certain common activities with other organizations.

32.79 Between June 1998 and March 1999, the Department entered into five exchange-of-information agreements with Workers Compensation Boards. Three other provinces have also expressed an interest in entering into such an agreement. In most cases, the agreements provide for the payment to the Workers Compensation Boards of retroactive benefits due to beneficiaries, where such amounts are to be recovered by the Boards. Discussions are also under way to develop more collaborative arrangements to support mutual clients, such as joint vocational rehabilitation.

The Department has revised its procedures and is now able to provide more realistic estimates of mispayments.

The Department recognizes that many individuals with a disability want to work or to do volunteer work.

There is a significant difference between the CPP and the QPP in their respective roles regarding the provincial Workers Compensation Boards.

32.80 To date, information has been exchanged with two provinces. With regard to the other agreements, system compatibility problems will need to be resolved before any information can be exchanged and the agreements become operational.

32.81 The Department has entered into discussions with an association of insurance companies to improve relations between CPP Disability and private insurers and improve client service. The matter has been placed on the agenda of the association's standing committee and a sub-committee has been set up to work on the issues raised.

32.82 Pilot projects have been carried out in one province to pursue methods of integrating common vocational rehabilitation activities. One pilot project has now been completed and its evaluation suggests that efforts to eliminate barriers to the re-entry of beneficiaries to the labour market should be continued. The evaluation also shows that it is important to maintain the relations established between the different partners — CPP, the province and the private sector — throughout the project.

The Disability components of the Canada and Quebec Pension Plans were compared within the context of the 1996 program evaluation

32.83 In 1996, we recommended that the Department identify and evaluate the effects of significant differences between Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) Disability benefits. We also recommended that the results of the evaluation be made available to the federal and provincial authorities in a timely fashion.

32.84 In September 1996, the Department released the results of the evaluation of the Disability component of the CPP. The evaluation compared the CPP and QPP and identified the differences between the two disability

programs. It concluded that bringing the CPP into line with the QPP would not necessarily result in long-term savings for the CPP.

32.85 The evaluation report nonetheless noted a significant difference between the two programs in their respective roles regarding the provincial Workers Compensation Boards. If the CPP were to play a similar role to that of the QPP with regard to the Commission de la santé et de la sécurité du travail (Québec), provincial Workers Compensation Boards would be placed in the position of first payer and fewer persons with disabilities would be referred to the CPP. Although the recent legislative amendments have made it possible for the CPP to adopt such a position, no steps have yet been taken in this regard.

The Department has begun to collect data to assess its performance in managing the CPP Disability program

32.86 Since 1996, the Department has developed a Management Information Framework to identify the needs of its managers and opportunities for collecting and using CPP Disability data. At the same time, it has improved its trend analysis system and has developed a new reporting database, which is beginning to produce data on various aspects of program performance. The Department is expecting CPP Disability management data to be available by fall 2000.

The Annual Report contains more information on CPP Disability activities, but it is released too late

32.87 The Department now provides more complete information on CPP Disability activities in the CPP Annual Report. However, the Annual Report for 1997–1998 was not released until fall 1999, some 18 months after the end of the fiscal year in question. It would be beneficial if the Department released the CPP Annual Report within a reasonable period of time following year-end.

Canada's Export Promotion Activities

— 1996, Chapter 25

*Assistant Auditor General: David Rattray
Director: Lewis Auerbach*

Background

32.88 The most valuable services that the federal government provides to existing and potential Canadian exporters are market information and intelligence, troubleshooting, and face-to-face counselling. The primary service deliverers are trade officers at International Trade Centres (ITC) in Canada and in the Trade Commissioner Service at Canadian embassies and consulates overseas. As well, useful assistance is made available on the Internet. The government also provides financial assistance to new exporters.

32.89 In our 1996 chapter, we concentrated on services provided by two departments — the Department of Foreign Affairs and International Trade, and Industry Canada. These departments together had the largest expenditures in international business development (about 85 percent of total government expenditure of about \$375 million).

32.90 We reported that there was a need for improved information on costs, revenues and benefits and made several recommendations for managing the services with greater regard to economy and efficiency. We recommended that Foreign Affairs and International Trade, in consultation with its government partners, table in Parliament a performance report on the overall performance of the 22 departments and agencies involved in the government's export promotion efforts. We also updated our 1987 observations to the Standing Committee on Public Accounts in support of cost recovery and recommended that charging would provide useful input for the development of good performance

indicators and help the service providers to concentrate on businesses with the greatest potential for export success.

32.91 In August 1997, responding to a request from the Public Accounts Committee, Foreign Affairs and International Trade and Industry Canada submitted a detailed status report containing plans to implement the recommendations in our chapter. In the spring of 1998, when we would normally have undertaken a follow-up review, implementation of the planned initiatives was in a preliminary phase. We decided to delay our follow-up for a year so that we could observe the changes implemented in the field, rather than report to Parliament only on departmental plans.

32.92 In 1997, the Team Canada approach to exporting evolved to become Team Canada Inc in order to reflect the participants' vision of a "virtual" trade agency. Team Canada Inc linked the 22 federal Team Canada members with provincial and territorial departments and agencies that deliver export development services. For example, the various individual plans are linked in the Team Canada Inc Business Plan, which is a document designed to promote consistency of approach and focus. The collaborative approach also involves 10 Regional Trade Networks and 12 Trade Team Canada Sector teams that are in the process of defining how they will pool resources to develop common products and services to assist Canadian businesses in finding international business opportunities.

32.93 In 1997, Foreign Affairs and International Trade also began the Performance Measurement Initiative (PMI), aimed at achieving operational

Departmental initiatives have led to operational improvements.

Progress on some of our recommendations is limited.

improvements in the Trade Commissioner Service. These improvements are designed to better manage client expectations and to help trade officers abroad focus on activities that, from the perspective of Canadian exporters, are the most likely to provide added value and results.

Scope

32.94 We reviewed the 1997 status report to the Public Accounts Committee as well as the subsequent status reports and supporting documentation that we asked both departments to provide in the spring of 1999. We also conducted interviews and reviewed documentation at three International Trade Centres in Canada, three Canadian embassies abroad, two consulates in the United States, and at headquarters in Ottawa.

Conclusion

32.95 We found that the Performance Measurement Initiative and Team Canada Inc are still in relatively early stages of implementation. Both have already led to operational improvements and have the potential to lead to more. Specifically, they have the potential to improve service delivery, help manage client expectations, more clearly define core services and increase the ability of trade officers to spend time on matters to which they can add the most value.

32.96 Progress is much less evident in those areas where we recommended actions that would improve accountability for results and provide knowledge useful for managing international business development activities with greater regard to economy and efficiency. The departments have decided not to implement a framework for charging for services. Although there are plans in place to improve the situation, neither department currently has systems in place to enable them to manage with adequate knowledge of the cost and commercial worth of the individual export promotion

services and products they deliver. The new annual report that we recommended on government-wide efforts in international business development emphasizes "achievements" and anecdotal success. It does not report on expenditures, costs, revenues and performance indicators that would shed light on whether the funds are being spent on matters that will best advance Canada's overall economic objectives; nor does it clarify the extent to which the specific goals of the program are being met. The departments' view is that our evaluation of progress did not take into account "the natural progression of steps required to implement an adequate accountability and reporting framework."

32.97 The departments believe that the measures they are planning or have already introduced will be sufficient to ensure that the operational improvements they have achieved will be sustained. We remain concerned that the significant progress we have observed on many operational matters will not be sustained if our other recommendations are not implemented.

Observations

Service delivery

32.98 Services are more clearly defined. Good progress has been made on our recommendation that core services be defined. The Performance Measurement Initiative identified six core services to be provided free of charge at foreign posts:

- market prospects — general assessments of market potential and barriers;
- key contacts search — identification of additional local sources of more detailed information;
- local company information — information about local companies identified by the potential exporter;
- visit information — help in timing and organizing a visit;

- face-to-face briefing with a trade officer; and
- troubleshooting — help with issues related to market access.

32.99 Domestically, federal-provincial partners of Team Canada Inc agreed on five core service areas:

- general information;
- skills development;
- export counselling;
- market entry support; and
- trade financing.

International Trade Centres focus on export counselling and market entry support.

32.100 Defining and communicating to clients what core services will be provided and what clients should do for themselves is an important advance; however, further work is needed. In our visits to foreign posts and International Trade Centres, we found general agreement on what the core services are, but variable opinion on how much "core" service should be provided. In particular, it was not clear when a "core" service starts to become "enhanced" as a result of a very high level of officer effort.

32.101 According to officers that we interviewed, particularly demanding or interesting clients receive 20 or more hours of individual officers' time over the course of a year, compared with the hour or so typically provided. Depending on the officer, this higher level of service costs between \$2,000–\$4,000 of time and overhead per officer per year. The variation in levels of service is also consistent with the results of Foreign Affairs and International Trade's 1998 client survey in which 54 percent of the business respondents complained that service quality and levels varied from one post to another.

32.102 It is not clear that the extra resources devoted to clients who demand more service are justified by improved results. The departments need to define more clearly what level of effort is acceptable in providing core services. In the present situation, it is possible to provide, free of charge, extensive core services to an experienced and/or new "export-ready" client that are not made routinely available to all clients.

32.103 A strenuous effort is being made to better manage client expectations. In our 1996 Report, we observed that officers believed their time was not used productively at posts abroad when business clients were not ready to export. Their dilemma was that they had difficulty saying "no" because of the understanding that all clients were equally entitled to a certain level of service.

32.104 One of the Performance Measurement Initiative's clearest accomplishments is the establishment of a system to assist officers to communicate with business clients and to provide templates for referring non-export-ready clients to services available in Canada. Other key elements of the system include a well-designed Intranet site, thorough training, documentation of best practices, regular employee and client surveys, and the establishment of a support unit at headquarters to help officers abroad deal with specific issues where client expectations may need to be managed. Trade officers claim that they can now focus better on clients with the most export potential and on activities most likely to provide added value. There are also plans to extend the PMI to non-business clients, such as other government departments and other levels of government. However, the lists of core services will not be finalized until after a consultation process.

32.105 Implementing more uniform practices can produce operational improvements. Trade officers now have a common set of guidelines and list of

Defining and communicating to clients what core services will be provided and what clients should do for themselves is an important advance.

One of the most valuable export promotion resources is officer time and expertise.

services for services to be provided abroad. However, we also found instances where more uniform practices would improve performance. For example, in 1996 we observed that too often Canada-based staff arrive in a new location and do not have the benefit of the experience of their predecessor, in the form of transition notes and files. Given that it costs, on average, \$300,000 per year for an overseas posting, it is important that new officers be up to speed in the minimum time possible.

32.106 We recommended to Foreign Affairs and International Trade that preparation of a transition package be required and become part of the performance appraisal process. However, most of the officers that we interviewed had not received an adequate set of transition notes and files. Recently, a set of guidelines for handover notes was sent to all officers, but preparation seems to remain a matter of individual choice. We hope that where more uniform practices are desirable, guidelines will continue to be introduced and their implementation monitored.

32.107 Defining appropriate levels of service for trade missions and high-level visits still needs attention. Expectations for levels of service can be very high, and inappropriately so. One result can be that business clients must sometimes wait for service until the visit is over. Are these visits worth the expense? No one really knows because the departments do not have adequate cost information or comparative evaluations of the visit outcomes. What is clear is that the level of service provided and costs covered are far more extensive than for other types of events. We recommended in 1996 that an informal "contract" be used to help define roles, responsibilities and who pays for what when a trade mission comes to a post. Foreign Affairs and International Trade has indicated that after consulting with Team Canada Inc partners, it will implement such a contract for most

missions and high level visits. With respect to the scheduling of high-level provincial and federal trade missions abroad, the Department noted that a mechanism is being developed with the provinces that aims to achieve a more co-ordinated and rationalized approach. As we note (paragraph 32.113), there will still be a need to obtain and provide information on the costs of these missions.

32.108 Support tools for trade staff have improved. The Performance Measurement Initiative is an especially effective support system for trade officers abroad. Domestically, implementation action plans are in place for the core services defined so far, and officers and their clients are both using Export Source, a web search engine with hot links to other export-related sites, and the 1-888 Export Information Service. In 1998, Team Canada Inc was one of 20 federal teams and individuals to receive the first Head of the Public Service Award. If the departments maintain their current level of high commitment, trade officers and the clients they serve will benefit.

Information on costs and results

32.109 Information for managing and reporting needs to be improved. In 1996 we recommended that cost and results information be used to manage trade resources and to report to Parliament. There are plans and pilots under way that may lead to useful improvements, but we did not observe that such information is systematically being used either for resource allocation purposes or for reporting to Parliament.

32.110 More information is needed on officers' activities and use of time. One of the most valuable export promotion resources is officer time and expertise. Foreign Affairs and International Trade recently conducted an employee survey that included questions on how officers spend time; the Department intends to repeat the survey annually. This is a major and commendable innovation for the

Department. However, employee surveys have limits because of their infrequency and inability to continuously track activities. Moreover, the Department's first survey did not inquire about the new core services in terms of cost, workload or impact. As a result, the workload indicators derived from it do not give information about the relative value and cost of the core services. The Department told us that future surveys will give such information.

32.111 Industry Canada has less information about how its trade officers spend their time, but has plans to conduct focus groups in the fall of 1999 on officers' perceptions about effective use of their time, best practices, and workload.

32.112 Time reporting is needed, in addition to employee surveys. In our 1996 Report, we observed that by abandoning the elements of the old Trade Tracking System, which tracked the above-noted sort of information, Foreign Affairs and International Trade had no way of knowing, on an ongoing basis, which activities are most time-consuming and therefore most costly. We also noted that Industry Canada did not have a tracking system of any kind. We continue to recommend that since trade officer time is one of Canada's most valuable export promotion resources, the departments institute a time reporting system so that they can track, on a continuing basis, how officer time is spent. Foreign Affairs and International Trade believes that the employee survey, together with other information, is a preferable tool for measuring workload and assessing costs of individual services. Industry Canada has informed us of plans to ascertain, through an activity-based costing study, the cost of the core and enhanced services offered by International Trade Centres. It is important to note that both departments agree that without information on how officers spend their time, it will not be possible to know the cost of services they provide.

32.113 Greater transparency is needed on the costs of high-level missions and visits. When a post absorbs costs for transportation, communications, spousal programs, and so forth, the cost of a visit may appear to be lower than it actually was. The total costs to the federal government of these visits, however allocated to departments, should form part of the performance report to Parliament that we have recommended.

32.114 The departments have better information about the commercial value of the services they provide but improvement is still needed. Knowing costs is not enough. It is also important to know how much the service is worth, in dollar terms, to clients. In the spring of 1999, Foreign Affairs and International Trade completed a client survey. The Department intends to repeat this survey annually. The survey provides valuable information about levels of client satisfaction and dissatisfaction that could be broken down by such factors as size of client, location of post and type of service. However, because of confidentiality considerations, the survey cannot provide feedback about specific transactions and products delivered by officers at specific sites; nor does it ask questions about what businesses believe the products and services they received were worth.

32.115 Industry Canada reported to the Public Accounts Committee in 1997 that "templates have been developed to allow International Trade Centres to measure the value of particular services to their clients." The Department informed us that these templates were never adopted because of the work in progress to define core services. Officials stated that when definitional work is completed, the Department may begin to track activities. The Department also has plans to conduct focus groups with clients.

32.116 While client surveys and focus groups provide useful feedback on a periodic basis, willingness to pay for export promotion services, as measured by

Willingness to pay for export promotion services, as measured by actually charging for them, would be an excellent ongoing performance indicator.

actually charging for them, would be an excellent ongoing performance indicator of the commercial value of the different products and services.

32.117 An appropriate framework for charging for services has not been implemented. We continue to believe that charging for services would help filter out business clients who are not seriously interested in exporting and would help give valuable feedback on the perceived commercial worth of the services provided. In its status report to the Public Accounts Committee, Foreign Affairs and International Trade agreed that there are potential benefits that can be derived from charging. They pointed out that the benefits “include measuring the effectiveness of the services provided as well as their commercial value to business clients.”

32.118 Concerning an approach toward deciding whether to implement charging, Foreign Affairs and International Trade said, “The Performance Measurement Initiative will guide the Department’s approach to these issues [and] will propose a realistic and feasible service charging scheme. A proposal for such a scheme should be available by the end of March 1998.” It pointed out that because there are many departments involved, “A common framework for charging will be closely associated to a common framework for services delivery.” Industry Canada added that it is “currently evaluating the merits of charging service fees. A formal report [that may never have been completed] on the issue of service fees for ITCs is due in the fall [1997].”

32.119 Such a realistic and feasible charging scheme was never presented. At the end of the follow-up, the departments informed us that in late 1998 they had rejected charging “for the foreseeable future.” Where feasible, clients might pay for or share costs for items such as travel, food, exhibit space or hotel rooms, because these were costs that did not

involve charging, either directly or indirectly, for officer time. In the departments’ view, this would be a more effective vehicle to address the question of charging for export promotion services. However, we were not able to find a written record of this decision; nor was it communicated to the Public Accounts Committee.

32.120 The departments offered several reasons why charging should not be implemented. They include the following:

- Charging is inconsistent with the government’s objective to double the number of small and medium-size enterprises that export.
- Informal consultations with some business clients revealed little or no support for such a scheme.
- Both departments are concerned that unless there is agreement among all Team Canada Inc partners on charging, the scheme could not be implemented. Furthermore, they believe that such an agreement would be costly and difficult to negotiate.
- According to Foreign Affairs and International Trade, instituting charging would involve organizational and cultural transformations that the Department fears would involve lengthy disruptive transition periods for clients.
- Departmental accounting systems and business rules would have to be changed to allow for efficient costing, charging and collection of funds.
- The departments concluded from a review of the charging practices of many of Canada’s major trade partners and competitors (U.S., Britain, Australia, France, Norway, Sweden, Finland, Germany, and four others who charge for services) that the charging regimes of these global competitors could not realistically be duplicated in Canada. The major reason was that the organizational structure for delivering export promotion services in Canada is “within a large and

In 1998, the departments rejected charging for export promotion services in the foreseeable future.

complex ministerial structure,” as compared with the more specialized agencies and organizations in the other countries.

32.121 At the field level, a few officers whom we interviewed pointed out that charging for services might result in demands for higher-quality service by client companies. Most were comfortable with this challenge. Their views are consistent with the findings of the Foreign Affairs and International Trade study on charging practices in other countries. The study described the significant changes required of trade officers in order to adapt successfully to a new regime for which services were charged.

32.122 We believe that the departments’ reasons for not charging for officer time include several challenges for implementation, but they do not constitute a compelling case for continuing the status quo. Charging offers opportunities for delivering export promotion services more economically and efficiently and with a greater knowledge of what clients want, need and are willing to pay for.

32.123 Indeed, we observed a wide variety of cost-sharing arrangements and instances where Canadian businesses already pay to attend certain government-assisted, export-related events and courses. The willingness, or lack thereof, to pay for these services in these instances can provide useful feedback to Team Canada Inc.

32.124 We also note that Canada’s major competitors, including the U.S., Britain and Australia, all continue to charge for various export promotion services and products that Canada still provides free. We plan to continue to pursue this issue and to raise with both departments the merits of our recommendations to implement a charging scheme.

Information technology

32.125 An appropriate overall plan is still needed. An overall plan for Team Canada Inc would require that each department use compatible models of how trade promotion functions and would demonstrate how each department’s information technology (IT) plans for trade align with the trade promotion business. For example, Foreign Affairs and International Trade needs to have such a model in order to provide the appropriate tools to staff both in Canada and abroad. Although we did not observe an overall plan for the role of IT in trade promotion, there have been many positive changes, including a far greater use of the Internet, implementation of a Canada-wide toll free number (1-888-811-1119) for export promotion assistance, and upgrades to existing technologies and software. As well, the departments say they will continue to explore, with other Team Canada Inc partners, ways to improve the compatibility of IT systems and products.

32.126 WIN Exports, a key information technology tool, is not working properly. A simple example demonstrates that it is essential to have a model that makes clear which services are best provided abroad and which are better provided in Canada. For example, the added value of locally engaged staff comes from their knowledge of and access to foreign companies and governments. To help foreign companies interested in acquiring Canadian goods and services, they are expected to use WIN Exports, a potentially powerful on-line information system with extensive data on Canadian exporters. WIN Exports is designed to generate business leads for these companies, track the services they receive, and generate information useful for management. Consequently, locally engaged officers spend considerable time searching WIN Exports, at the expense of gaining or imparting further information and intelligence about the foreign market.

Canada’s major competitors charge for various export promotion services and products that Canada provides free.

The Department of Foreign Affairs and International Trade is aware of and committed to resolving the technical issues surrounding WIN Exports.

How can the system be best configured and maintained so that officers at foreign posts use their time more productively? An IT plan based on an appropriate model would address this and similar issues.

32.127 Apart from the above-noted observation that WIN Exports is not used in an optimal fashion, the tool has a more serious immediate problem. It causes officers' computers to hang up or crash, and officers are therefore reluctant to use the system. This means the data in WIN Exports are becoming increasingly out-of-date. The consequence is that officers waste time when they try to use the system, and foreign posts and International Trade Centres may not have accurate information about companies or whether they are receiving services elsewhere. WIN Exports' inability to function properly seriously impacts on the ability of departments to deliver a high-quality export promotion service. Foreign Affairs and International Trade has indicated to us that it is well aware of these issues and is committed to resolving them.

Reporting to Parliament

32.128 Performance reporting to Parliament is better, but is still not adequate. Because over 20 departments and agencies are involved in export promotion, our 1996 Report recommended that the Minister of Foreign Affairs and International Trade, in consultation with the Minister of Industry, prepare a performance report on the government-wide international business development program. The first such report, a "progress report", was tabled in 1997. In a status report to the Public

Accounts Committee, the departments indicated that the 1997 Report was only the first step toward implementing our recommendation and that "future reports would include performance indicators at the industry level, performance targets and, most important, measures at the [service] delivery level and an evaluation of program performance to allocate resources where they have the most impact."

32.129 The third, and most recent report, in 1999, on "achievements" of Team Canada Inc, is a clear improvement over the situation that prevailed in 1996, but it still does not meet the commitments that both departments made in 1997 to the Public Accounts Committee. The departments need to provide a report that:

- relates the reported achievements to the costs of providing the service;
- combines information on macro, governmental and departmental performance targets and whether they have been achieved (for example, reporting on the number of small- and medium-sized enterprises served by the government that have become new exporters);
- provides measures of client satisfaction that compare services provided on a cost-shared or charged basis; and
- reports on measures for the success of the service as a whole.

Without this kind of report, Parliament will not know whether trade services are having the desired effect and whether they could be provided more economically.

Acquisition Cards — 1997, Chapter 7

*Assistant Auditor General: Doug Timmins
Director: Bruce Sloan*

Background

32.130 In April 1997, we reported the results of our audit on the use of acquisition cards. We concluded that departments and agencies required better control procedures, monitoring and analysis of card use. We made the following two recommendations:

- The Treasury Board Secretariat (TBS) should work with other federal organizations, acquisition card companies and suppliers to improve the acquisition card program and to strengthen control over card use.
- Departments and agencies should review their strategies and plans for the use of acquisition cards, analyze the use of cards and determine what controls best meet their needs to manage the risks associated with the use of acquisition cards.

Scope

32.131 Our follow-up work consisted of a review of key documents in three entities included in our original audit — Fisheries and Oceans, Natural Resources Canada and the Royal Canadian Mounted Police. We conducted interviews with departmental officials responsible for the administration and use of acquisition cards and with officials of Public Works and Government Services Canada (PWGSC) and the Treasury Board Secretariat to discuss and assess actions taken in response to our 1997 recommendations.

Conclusion

32.132 Progress has been made since our audit in 1997. Departments and agencies now have the necessary tools to enable them to control and monitor card

activities. These include a revised Treasury Board Secretariat policy and management guide on acquisition cards as well as electronic tools offered by the acquisition card companies.

32.133 However, it is important to note that the extent and use of acquisition cards has grown substantially since they were first introduced in 1991. By their nature, acquisition cards involve a higher degree of risk because the control of card use rests with an individual, and monitoring by entities takes place after the transaction has been completed. As a result, there will always be concerns about errors and/or abuse going undetected when using acquisition cards for government business.

32.134 Departments and agencies need to continue to ensure that appropriate controls for acquisition card use are in place, operating as intended, reviewed periodically, and conducted with prudence and probity and within the policy and guidelines established by the Treasury Board Secretariat.

Observations

Continued growth in the use of acquisition cards

32.135 A government acquisition card is a credit card that is used to purchase and pay for goods and services, excluding travel and vehicle operations, for federal departments and agencies.

32.136 The use of acquisition cards within the federal government has continued to grow since the inception of the card program in 1991. The number of cards and transactions and the volume of expenditures have increased significantly since our audit in 1997:

- There are now approximately 26,000 acquisition cards issued to

Progress has been made since 1997.

Departments and agencies need to continue to ensure that appropriate controls for acquisition cards are in place and operating as intended.

government employees (30 percent increase).

- Annual transactions on acquisition cards exceed 1.3 million (221 percent increase).
- Expenditures on acquisition cards have risen to more than \$355 million (207 percent increase).

Acquisition card contractors

32.137 New contractual agreements for acquisition cards were entered into with National Bank MasterCard and Citibank VISA, effective 1 January 1998. These contracts emphasize the electronic exchange of information and the implementation of better information, and the monitoring and control tools for federal government entities. For electronic reporting, National Bank MasterCard offers *SMART DATA for Windows* and Citibank VISA offers *INFOSCAN*. These software products allow departments and agencies to choose from several standard reporting formats or to create ad hoc reports. Currently, twenty-seven entities use *SMART DATA* and one entity uses *INFOSCAN*.

32.138 The two companies offer a variety of payment options involving rebates, with one option involving fees. In 1998–99, rebates paid to departments and agencies were approximately \$1 million of a potential \$1.8 million. Rebates valued at about \$800,000 were lost due to late payments by departments.

Instances of misuse of acquisition cards continue to be reported

32.139 Over the last two years, seven departments and agencies reported 78 instances of misuse of acquisition cards in the Public Accounts of Canada, amounting to potential losses to the federal government of over \$17,000. Of this amount, \$7,300 has been recovered. It is expected that an additional \$7,400 will be recovered in future years.

Other observations on credit card use

32.140 In Other Audit Observations, Chapter 33 of this Report (paragraphs 33.9 to 33.30), the Office reports on the misuse of vehicle fleet credit cards. The audit note highlights the risks associated with the use of these cards when insufficient controls are in place.

Central agency initiatives

32.141 In response to the recommendations contained in our 1997 audit, the Treasury Board Secretariat issued a revised policy on acquisition cards in July 1998. It emphasizes the need for additional controls at the departmental level, improved monitoring and analysis, and the use of information provided by the contractors in an electronic format. Twelve organizations have some form of electronic information or data interchange with card companies.

32.142 The policy states that the Departmental Acquisition Card Co-ordinators are responsible for authorizing the issuance of cards and for monitoring the program designed to ensure that reliable controls for the cards are in place and working. In addition, the policy provides detailed guidelines on such things as overall program management, card issuance, restrictions and obligations regarding the use of acquisition cards and how to handle disputed items.

32.143 In 1998 the Treasury Board Secretariat issued version 1 of the *Acquisition Card Program — Best Practices Guide*. The Guide provides entities with examples of leading practices in the management and monitoring of the use of acquisition cards. Version 2 of this Guide was released in the fall of 1999 and renamed *Acquisition Card Program — Management Guide*. It contains useful information on the history, use and benefits of acquisition cards, describes the acquisition card control framework, discusses recommended practices for acquisition cards, and highlights internal

controls that will assist managers in monitoring card activities.

Management review of acquisition card transactions

32.144 In each of the three entities included in our follow-up, management has implemented practices to improve their control framework and to reduce the risks associated with acquisition card transactions. Departmental initiatives include:

- reducing acquisition card limits in order to reduce the departments' exposure in the event of misuse;
- using information technologies to provide more timely monitoring of acquisition card transactions;
- implementing an Automated Acquisition Card Registry (AACR) and developing a user guide that describes how to make the best possible use of SMART DATA and AACR to monitor card use; and
- developing a Web-based course on procurement that includes a component on acquisition cards.

The work of internal audit

32.145 An effective internal audit group is one of the key mechanisms through which departmental management may receive independent assurance that the control framework implemented within the department is operating as intended and that departmental acquisition card transactions are operating in accordance with Treasury Board Secretariat policies.

32.146 In March 1998, Natural Resources Canada published a follow-up audit on the MasterCard-Electronic Data Interchange initiative and has reviewed acquisition cards as part of other functional and organizational audits. Internal Audit continues to monitor acquisition card purchasing levels on a quarterly basis.

32.147 The RCMP's 1999–2000 Review Plan includes an audit of acquisition cards, and PWGSC is currently undertaking a credit card audit that includes travel cards, acquisition cards and fleet vehicle cards to determine the adequacy of the management control framework for the use of these cards.

Department of Finance — Equalization Program — 1997, Chapter 8

*Assistant Auditor General: Ron Thompson
Principal: Jeff Greenberg*

The Department of Finance has gone to considerable effort in trying to address and resolve the issues that we raised in our 1997 chapter.

Background

32.148 The equalization program provides unconditional transfers to the provinces. These payments are made on the basis of a formula that estimates the capacities of provinces to raise revenues by taxes and other levies, and compares them with a standard. Any province whose fiscal capacity is lower than the standard is entitled to equalization payments sufficient to raise its capacity to the standard. At present, only British Columbia, Alberta and Ontario are not eligible for equalization payments.

32.149 In Chapter 8 of our April 1997 Report, we reported the findings of our audit, which focussed on the systems and practices that the Department of Finance has in place to assess performance, to keep Parliament informed and to administer the equalization program.

32.150 Our intention in reporting in April 1997 was to give the federal government and the provinces an opportunity to examine our findings in light of the need to obtain parliamentary approval for the continuation of this program beyond 31 March 1999.

Scope

32.151 The follow-up for this chapter was carried out by reviewing the contents of Bill C-65, *An Act to Amend the Federal-Provincial Fiscal Arrangements*; this legislation renewed the equalization program as of 1 April 1999. We also reviewed the background material provided to members of Parliament for Bill C-65, specifically the section describing the Department's response to our 1997 recommendations.

Conclusion

32.152 We believe that the Department of Finance has gone to considerable effort in trying to address and resolve the issues that we raised in our 1997 chapter. Every one of these issues was discussed with the provinces and many were responded to in Bill C-65. The changes enacted had a significant financial impact for the federal government and resulted in payments being more consistent with the principles of the program. Some of the issues we raised could not be resolved at this time, but the Department made commitments to continue seeking ways to deal with them.

Observations

Achieving comparable revenue-raising capacities

32.153 Through Bill C-65, the federal government made considerable changes to the Representative Tax System (RTS) to better reflect the taxing potential of the provinces. Specifically, it made changes to the Act with respect to the taxing potential of mining and minerals, oil and gas, timber and lotteries. It also made a number of changes to other tax bases, such as provincial sales taxes, to ensure that these bases measure fiscal capacity in the most accurate way. As well, consistent with our suggestion, the government made changes to reduce the impact that user fees had as a source of revenues for purposes of equalization.

32.154 We also proposed that changes be made to the treatment of property taxes. While the federal and provincial governments were unable to arrive at an alternative measurement of the revenue capacity for this revenue source, they agreed to continue examining ways to improve the method of calculating this source.

Maintaining a program that is sustainable for the federal government and provides stability for the provinces

32.155 Consistent with our suggestion, the Department of Finance sought parliamentary approval to change the way the ceiling is calculated. By setting the ceiling level for the first year, this change provides protection to the federal and provincial governments from abnormal swings in the first year. The new legislation also changed the way the floor worked so that those provinces that had small changes in fiscal capacity would not be susceptible to significant changes in entitlements.

Remaining accountable

32.156 We also commented on the accountability of the government to Parliament with respect to this program. We were concerned that those to whom the government is ultimately accountable are often left out of the deliberations until well after federal and provincial officials and the ministers involved have completed their discussions about the terms of the revisions. We indicated that the process needs to be opened up to facilitate wider participation in the consideration of changes to such a fundamental program.

32.157 Based on our observations of Bill C-65, this did not happen. Although MPs were well briefed about this program and the proposed changes, the legislation was not introduced until early February 1999 and the Bill needed to have

Royal assent before 1 April 1999. While the Department indicated that it would respond to any request of Parliament, we continue to believe that the initiative must begin with the Minister and the Department for providing MPs with material well before the date the new legislation is required.

32.158 As part of accountability, we also indicated that meetings with provincial officials should be held on a continuous basis, if the difficult issues like measuring the revenue-raising capacity from property ownership are to be solved. We understand that this process has begun.

Administration of the program

32.159 We found that the administration of the program was well run. We did note, however, that there was a difference in the timing of the recovery of overpayments versus the compensation for underpayments to the provinces. We recommended that the Department of Finance, in conjunction with the provinces, review this matter and determine whether interest should be paid on such balances, keeping in mind the impact on other financial programs.

32.160 The government discussed the matter in depth with provincial officials and they agreed that this was an area that needed further attention. They further agreed that it would be reviewed in conjunction with the tax collection agreements since those agreements are also subject to temporary over and underpayments.

The process of consultation with Parliament needs to be opened up to facilitate wider participation in the consideration of changes to such a fundamental program.

Foreign Affairs and International Trade — Financial Management and Control — 1997, Chapter 9

Assistant Auditor General: David Rattray

Director: Paul Morse

Background

32.161 In our 1997 audit of financial management and control at the Department of Foreign Affairs and International Trade, we focussed on four areas: Financial Management, Property Management, Managing Information Technology (no recommendations were made), and Foreign Service Directives.

32.162 We concluded that where the Department had emphasized improving practices and controls in specific areas, it had been successful. However, there were other areas where similar efforts were needed. We made nine recommendations, four of which dealt with property management issues.

Scope

32.163 Our follow-up work consisted of analysis of key documents as well as interviews with departmental officials.

Conclusion

32.164 We noted a lack of urgency in implementing a number of our recommendations; however, where the Department had focussed its efforts, it had made noticeable improvements. For some of our recommendations though, the Department is only beginning to take action on the issues we raised.

Observations

Financial management

32.165 In our 1997 chapter, we recommended that managers at missions and geographic area bureaus in headquarters compare actual expenditures by object for the year against initial

budgets and analyze significant variances. The Department agreed and, shortly after the end of our audit, its Executive Committee issued a directive that this be done.

32.166 Our follow-up found that this was not being accomplished. Although the senior financial officer reminded missions to carry out the analyses, there was no headquarters follow-up to the directive to verify compliance. Our review found that managers have continued to operate as before. We also determined that the configuration of the new financial and management information system (IMS), which was being implemented by the Department in 1998 and 1999, does not yet provide accounting information on a summary basis as before. This will make the type of analysis we recommended more difficult. (The Department plans to implement the capability by April 2000). We remain concerned that this basic budgeting and expenditure control has not been effectively implemented.

32.167 The 1997 audit found problems with the financial information supporting the original costing of the \$25 consular fee charged to passport holders. The follow-up found that the Department has kept its costing current and is using an acceptable methodology.

32.168 In 1997 we recommended that the Inspector General implement a system to follow up and report on action taken on the many valuable recommendations contained in inspection reports. Our follow-up audit found that the Office of the Inspector General is attempting to co-ordinate internal audits with inspections so that they occur at the same time. This has led to fewer detailed recommendations in the inspection

For some of our recommendations, the Department is only beginning to take action on the issues we raised.

reports. In early 1999, the Inspector General also indicated to the Departmental Audit and Evaluation Committee that all inspection reports would be followed up, six months after a mission inspection. The Committee subsequently approved the follow-up strategy.

Property management

32.169 Our 1997 chapter made four observations on the property management area, including the adequacy of long-term financial planning. We recommended that the Physical Resources Bureau's financial plans present likely annual expenditures and revenues, and show the financial impacts of accelerating or delaying projects.

32.170 Our follow-up found considerable improvement in financial planning. Although the planning formats have not changed substantially, the information in plans has been made more realistic and senior management has been better informed on financial planning alternatives.

32.171 In a 1994 chapter, we had noted that the Physical Resources Bureau was beginning to address information technology needs for property information. Our 1997 audit observed that the Department still lacked adequate information to manage its property. We recommended that the Department develop a database that includes property maintenance history, develop performance measures to improve property management and link property information to the financial system.

32.172 Our follow-up found some activity but little progress on that recommendation. In particular, the way the new financial system was set up has so far not improved the Department's capacity to link its property information to financial information. Bureau officials told us that the Department still has plans to develop a property information module

in its new IMS, once the financial module has been implemented at missions.

32.173 Our 1997 audit commented on maintenance spending, focussing on official residences. We recommended better co-ordination between Bureau and mission inspections and better co-ordination on budgeting and analyzing spending for individual properties. We also recommended that new inspections be done where missions planned significant spending on renovations or repairs not signalled as required in previous inspection reports.

32.174 The Department has improved co-ordination of efforts between missions, geographic bureaus and the Physical Resources Bureau in managing budgets for renovation and repair and in analyzing spending on properties. In 1998–99, Physical Resources Bureau maintenance managers and geographic financial advisers met regularly to co-ordinate the spending of their respective budgets at missions.

32.175 We also found that the Bureau had reminded missions that any maintenance spending over \$5,000 needed Bureau approval. All the missions had received copies of the draft Property Manual that provides guidance on conducting inspections. The Bureau developed a more comprehensive inventory of major maintenance requirements at missions on an in-house database and made a submission to the Treasury Board for funds to address deferred maintenance.

32.176 Inspection reports we reviewed did not always comment on work previously carried out or whether it had been correctly entered into property records; however, officials told us that Bureau inspectors do address these points and report on an exception basis. We were also told that rather than conducting new inspections, the Bureau often preferred to rely on its improved co-ordination efforts together with other less costly means to

The information in financial plans has been made more realistic.

The new financial system has so far not improved the Department's capacity to link its property information to financial information.

At the end of our follow-up, departmental representatives had begun to review a study's preliminary findings on representational housing.

assure itself that major unforeseen expenditures were justified.

32.177 We commented in our 1997 audit that program managers at missions were generally not meeting the guidelines on representational housing. We recommended that the Department re-examine its continuing need for representational housing. In the fall of 1998, the Department contracted for an independent study on a number of property issues. The study included questions on the use of representational housing. At the end of our follow-up, departmental representatives had begun to review the study's preliminary findings.

32.178 We reviewed the use of representational housing since 1997 at the Washington D.C. mission, which we visited during the original audit, to see if the Department had addressed our specific concerns with that mission. As in 1997, we found that none of the employees allowed the \$500 U.S. per month higher

rental ceiling for representational housing was meeting the conditions for maintaining a representational house. The mission conducted a study of its hospitality requirements. In 1998, for all new postings, it began using a property's location as a criterion for rent ceilings instead of the representational/non-representational criteria. At the time of our audit, negotiations were taking place with the Treasury Board Secretariat to gain acceptance of the new methodology.

Foreign service directives

32.179 In 1997 we commented on the working relationship between the Department of Foreign Affairs and International Trade and the Treasury Board Secretariat, with a recommendation that they integrate their Foreign Services Directives activities more effectively. Our follow-up found that the parties had achieved reasonable co-operation and a renewed recognition of each other's roles.

Household Goods Removal Services of the Federal Government — 1997, Chapter 21

*Assistant Auditor General: David Rattray
Director: Manfred Kuhnafel*

Background

32.180 In 1997, responding to a request from the Standing Committee on Public Accounts, we audited household goods removal services of the federal government. The audit focussed on the way that National Defence, the Royal Canadian Mounted Police (RCMP) and Public Works and Government Services Canada (PWGSC) managed household goods removal. We examined:

- the value obtained under contracting arrangements;
- the extent to which household goods removal was being managed economically and efficiently; and
- the controls in place to guard against the risk of overcharging.

32.181 Our 1997 audit found that government employees were less satisfied with the quality of service than relocated employees of other Canadian organizations, partly because emphasis was placed on obtaining the lowest price, not the best value. We also questioned the fairness of the contracting arrangements — particularly the formula for allocating business among qualified bidders. We noted the potential for overcharging due to “weight bumping”. (Weight bumping refers to the manipulation of a scaled shipment in order to inflate its weight.) The inherent risk that billed weights could be manipulated was high, yet controls to prevent it were weak. Moreover, we noted that efficiency could be improved through better use of information technology, including centralization. Finally, we suggested the possibility of savings on operating costs if an alternative to weighing shipments could be found as a

basis for invoicing the moves. We made several recommendations to the three organizations through the Interdepartmental Committee on Household Goods Removal Services (IDC).

32.182 In their joint response to our audit chapter, National Defence, PWGSC and the RCMP outlined a plan to achieve their management objectives — to strengthen the contracting framework, to improve management efficiencies and to pursue potential additional savings. In 1998, National Defence, in co-ordination with other members of the Interdepartmental Committee on Household Goods Removal, reported to the Standing Committee on Public Accounts on the status of actions taken to answer our recommendations.

Since our 1997 audit, the Interdepartmental Committee has taken steps to implement our recommendations.

Scope

32.183 In our 1999 follow-up, we reviewed the Interdepartmental Committee’s status reports on its progress in responding to our observations and recommendations, as well as supporting documentation it provided to us. We interviewed officials from National Defence, the RCMP and PWGSC to discuss and clarify the actions they had taken. We also interviewed representatives of moving organizations.

Conclusion

32.184 Since our 1997 audit, the Interdepartmental Committee on Household Goods Removal has taken significant steps to implement our recommendations. Over the last two years, the Committee explored and piloted new ideas. It implemented new arrangements aimed at making the contracting process

The first initiative was to improve the method of assessing contractors' performance.

fairer and more effective. It took some initiatives to strengthen and improve the household goods move-management function. Finally, it initiated two pilot tests: one to further improve the fairness and the effectiveness of contracting arrangements and the other to introduce an alternative to the existing basis on which moves are invoiced. How these efforts ultimately will be implemented in the contracting arrangements will have to be determined in future. We encourage the Interdepartmental Committee to continue, in consultation with the moving industry, exploring new avenues for fair and effective contracting arrangements and pursuing potential additional savings.

Observations

Getting better value from a fairer and more effective contracting arrangement

32.185 In 1997 we recommended that PWGSC, in consultation with the Interdepartmental Committee, implement a fairer and more effective contracting arrangement. The Committee responded by undertaking two initiatives.

32.186 The first initiative was to improve the method of assessing contractors' performance. The Committee developed a model that places more emphasis on relocated employees' satisfaction with the move, while still considering the extent to which the contractor has complied with the Committee's moving regulations. The IDC indicated that in the current contract period, it will validate the model on a trial basis, using a redesigned customer survey questionnaire and data on contractors' compliance. It also indicated that for the subsequent contract, it plans to use the validated model to reallocate business during the life of that contract.

32.187 The IDC's second initiative was to introduce, in collaboration with PWGSC, new contracting arrangements for the 1999–2001 contracting period.

These arrangements eliminated the previous practice of requiring all qualified bidders to contract for services at the price offered in the lowest bid submitted. The new arrangements mean that each potential contractor can submit a competitive proposal for different percentages of government business for which it elects to submit bids. Bidders currently holding a household goods contract with the federal government can bid to a maximum of 50 percent, while new bidders are limited to a maximum of 15 percent of government business. The Request for Proposals for the 1999–2001 household goods removal contract included these new contracting arrangements.

32.188 The Statement of Work for the 1999–2001 contract included a clause that allowed for piloting new ideas. It specified that innovative service delivery methods would be actively explored during the life of the contract. It committed the government to considering alternatives to the existing service delivery method and to implementing them, where feasible. Contractors were asked to forward ideas and to participate on a voluntary basis.

32.189 In 1997 we reported that the Competition Bureau had started an inquiry in May 1996 into allegations that one or more of the van lines had breached a 1983 Supreme Court of Ontario order by preventing affiliated carriers from providing services to the federal government except through the van lines. We commented that until the inquiry had been completed, the appropriateness of the existing system of allocating business would remain an open question. At the time of our follow-up, the Bureau indicated that the inquiry had not been finalized. Notwithstanding this, the IDC has since introduced a new method of allocating business to contractors for the current contract.

The second initiative was to introduce new contracting arrangements for the 1999–2001 contracting period.

Cost and efficiency of the household goods move-management function

32.190 Our 1997 Report recommended that the Interdepartmental Committee strengthen the household goods move-management function and improve its efficiency. We noted the need to make greater use of information technology. In its response that was included in our 1997 Report, the IDC said that the centralized use of National Defence's Automated Move Management System (AMMS), then being developed and scheduled to be finalized by April 1999, would enable the government to manage household goods removal services more effectively and efficiently.

32.191 Back in 1996, National Defence had begun to experience problems with its information system for managing household goods removal. These problems contributed to slowing down management operations and communications with contractors. The RCMP was also using National Defence's system at the time and these problems led it in May 1997 to transfer its household goods removal operations to the PWGSC system. The problems also caused National Defence to begin using the PWGSC system in June 1998, although the plan remained to centralize all operations once AMMS was operational. In October 1998, however, National Defence decided to discontinue work on AMMS due to difficulties integrating it with other internal systems that were being developed. The availability of alternative systems could not be guaranteed in time for the 1999–2001 contract period. In view of this, the members of the Interdepartmental Committee agreed that the most effective solution available was to use the PWGSC's automated system for all moving activities.

32.192 The PWGSC system has essential functionality to permit the management of moves, distribution of business and communications with contractors.

According to PWGSC, it is now also Y2K-compliant. The use of the same information system by all three members of the IDC permits some improvement in efficiency but less than the AMMS had been expected to provide.

32.193 In 1997, we noted that the household goods management control activities were conducted unevenly across the three member departments, and a number of them were not carried out at all. Currently, National Defence continues to perform quality control inspections and reweighs, and the RCMP continues to perform only quality control inspections. PWGSC does not perform quality control inspections and reweighs. The RCMP and PWGSC indicated that the lack of resources contributed to limiting the performance of these controls. All three departments rely on the verification of contractors' invoices.

32.194 During the 1997–1999 contract, using the same reweigh procedures, National Defence performed 50 percent more reweighs than in the previous contract period. However, in July 1999, it initiated a centrally funded quality assurance program to ensure that the removals policy, including its reweigh program, would be applied consistently across all National Defence units. The effectiveness of this program will have to be determined in the future.

Managing the risk of overcharging

32.195 In 1997, we recommended that PWGSC, in consultation with the Interdepartmental Committee and the moving industry, minimize the risk of overcharging and explore the possibility of a better alternative to the existing basis for invoicing moves. The Interdepartmental Committee, in partnership with representatives of the private sector, explored alternatives to scaling as a way to address the risk of overcharging due to weight bumping. ("Scaling" is the use of a weigh scale to determine the weight of a shipment.)

The Interdepartmental Committee agreed to use the automated system of Public Works and Government Services Canada for all moving activities.

In June 1999, the Interdepartmental Committee introduced a new process on a trial basis for determining the weight of household goods as the basis for invoicing a move.

Industry members were requested to develop their own lists of standard weights that would later be the basis for a homogeneous list of standard weights to be adopted by the industry.

32.196 For the 1999–2001 contract, the scaled weight remains the basis for invoicing all government shipments. However, in June 1999, the IDC introduced a new process on a trial basis for determining the weight of household goods as the basis for invoicing a move.

This new process uses a standard table of average weights and photographs of goods to be moved to determine the weight of a shipment. The IDC believes that such a process with appropriate controls could significantly reduce the risk of overcharging due to weight bumping. Two of the three contractors are using it in a trial to validate the table of weights and the process. If the trial succeeds, the Interdepartmental Committee intends to institute the process in the next contract period.

Systems Under Development — 1997, Chapter 23 and 1996, Chapter 24

*Assistant Auditor General: Doug Timmins
Principal: Eric Anttila*

Background

32.197 In Chapter 24 of our December 1996 Report, we examined four major government systems under development, and recommended that the Treasury Board Secretariat work with the departments to produce action plans to implement the principles of the Enhanced Management Framework for Information Management/Information Technology (EMF).

32.198 In Chapter 23 of our December 1997 Report, we reported on our risk assessments of three in-house information technology projects. We made a recommendation that had six components. They were that departments reduce their risks on systems under development by properly identifying and involving clients, preparing detailed project plans, developing business cases, using project charters, establishing independent quality assurance, and supplementing subjective measures of progress with objective measures such as time tracking.

Scope

32.199 In 1999, we continued our follow-up of Chapter 24, and reviewed the status of the Canadian Forces Supply System Upgrade and the Tactical Command, Control and Communications System projects at National Defence. We also did further follow-up of the Treasury Board Secretariat's co-ordination with departments to produce action plans for the principles discussed in the Enhanced Framework for the Management of Information Management/Information Technology.

32.200 In our follow-up of Chapter 23, we reviewed progress on the

recommendation we had made after examining the Self-Serve Systems at Human Resources Development Canada (HRDC), Standardized Accounting/Corporate Tax at Revenue Canada, and Strategis at Industry Canada.

Conclusion

32.201 National Defence still has significant risks to manage on the two large projects that we audited but continues to make progress and improvements.

32.202 The Treasury Board Secretariat has received 16 of 20 action plans from departments for the implementation of the EMF, and 4 of the 16 departments have submitted updates for their plans. The Secretariat has created a public Web site and an internal Web site where other departments can view these plans and share lessons learned and ideas for future action.

32.203 Our follow-up with the three departments audited in 1997 indicates that in two cases, HRDC and Industry Canada, all six components of our recommendation have been implemented. The third department, Revenue Canada, has implemented fully all but two of the components. The two components remaining have been implemented in part.

Observations

32.204 **Tactical Command, Control and Communications System.** The Tactical Command, Control and Communications System project (TCCCS) at National Defence (DND) is now at a turning point. Following the contract amendment of November 1998, the nine-year, \$2 billion project has been

National Defence still has significant risks to manage on the two large projects that we audited but continues to make progress and improvements.

Of the three departments we audited in 1997, Human Resources Development Canada and Industry Canada have implemented all six components of our recommendation. The third department, Revenue Canada, has implemented fully all but two of the components.

Overall, project management of the Tactical Command, Control and Communications System has made good progress since last year; however, because of the significant cost and technical risks, the Department believes that the project is at a medium risk level.

The Department estimates that the Canadian Forces Supply System Upgrade project will be delivering 80 percent of the original requirements, with the remaining 20 percent being implemented as part of normal in-service upgrades.

extended by one year and is due to be completed in September 2001, at no extra cost to the government for the contract. Following the agreement on a delivery schedule that ties in more closely with the realities of the project so far, the more sophisticated portion of the equipment (and the bulk of the order) is due to be completed, installed and formally accepted over the remaining term of the contract. Given the complexity of the project, the tight schedule and the potential impact on the operational capability of Canadian Forces, the project management team is continuing to monitor project risks very closely.

32.205 Overall, project management of TCCCS has made good progress since last year; however, because of the significant cost and technical risks, the Department believes that the project is at a medium risk level.

32.206 Canadian Forces Supply System Upgrade. Since its initiation in 1981 by National Defence, the Canadian Forces Supply System Upgrade (CFSSU) project has undergone major transformations. The latest one affects the contract that was signed in January 1995 to deliver a system in February 1999 that would have met DND's requirements for the inventory and distribution of its supplies, as well as the planning tools necessary for the logistical support of its operations.

32.207 In November 1996, our chapter highlighted the serious problems affecting the project. Two years of intense activity by the project management team and the contractor made it possible to switch from a custom-made solution to one combining two existing commercial packages. The overall budget of \$295 million remained the same but the target date slipped to September 1999; at the time of our follow-up report in December 1998, it had slipped further to February 2000.

32.208 Since our 1998 Report, delivery problems escalated to the

point that, by mutual agreement, the prime contractor and National Defence proposed to bring total system responsibility back to DND. With this proposal, as of 1 November 1999, DND will effectively become the prime contractor for the rest of the project. To stay within the limits of the remaining budget of \$63 million, the project management team is recommending working with one commercial package only, using a reduced staff, and delivering the revised acceptable functionality. Some functional capability that was part of the original project will be added after the current project is completed. A new target date of December 2001 is being proposed.

32.209 Because of the very tight budget remaining, the resulting resource constraints, and the major reorganization of the development effort, DND has developed a new implementation strategy with the goal of reducing the overall risk of what has been to date a high-risk project. Given the significant difficulties encountered by the project (close to a three-year schedule delay and the associated cost overruns), the Department estimates that the CFSSU project will be delivering 80 percent of the original requirements, with the remaining 20 percent being implemented as part of normal in-service upgrades. The new management and contractual framework that has been developed, with the contractor's acceptance, will see the Crown take over as prime contractor except for arrangements made within specific work tasks. Moreover, the Department says that the Crown will then be in a position to conclude the project successfully.

32.210 Treasury Board Secretariat. The work of the Treasury Board Secretariat in obtaining action plans for implementation of the EMF, monitoring their implementation and consulting with departments has been moving forward. The 20 largest departments were asked and agreed to share their plans for

implementing the first of four plateaus of the EMF by March 1998. We reported last year that by September of 1998, nine plans had been received. Up to September 1999, seven additional action plans have been submitted. Four of these sixteen contributors have submitted updates to their plans, demonstrating further commitment to the EMF implementation efforts. Four departments have not submitted any plans to date.

32.211 The Treasury Board Secretariat has recently set up a Web site for contributors to facilitate sharing. At the site, departments can post their plans as well as lessons learned, suggestions for further action, plan updates and other topical items. A Web site that is open to the public has also been created.

32.212 The EMF has been expanded to include best practices for managing all investments in the Information Management/Information Technology portfolio.

32.213 Self-Serve Systems. The management of the Self-Serve Systems projects at Human Resources Development Canada has continued to pursue the initiatives that we noted in our December 1997 chapter. However, activities are very reduced so that priority can be given to the year 2000 problem. Processes are being improved though, and governance issues such as business planning and priorities are being addressed. Managers are using time tracking to supplement subjective measures of progress. Business cases and project charters are being prepared for all projects. The quality assurance function, which was well established when we reviewed the projects in 1997, has been strengthened and is now involved in all projects. More effort is now going into identifying and involving users. The Department is also implementing improvements to its systems development processes in line with the Secretariat's EMF.

32.214 Standardized Accounting/Corporate Tax. The Standardized Accounting and the Corporate Tax Systems (SA/T2) projects at Revenue Canada have experienced staff turnover and some other problems. These problems have caused delays that have pushed final implementation from the original target of April 1998 to June 2000. The overall budget is expected to rise to \$160 million from the \$106 million that we reported in 1997. Revenue Canada, as we reported in 1997, has done a good job of identifying and involving clients, planning, and using business cases and project charters. Although there is no independent quality assurance function, as we noted in 1997, there are quality control steps throughout the Department's development processes. Also, while there are not yet objective measures of progress to supplement subjective judgments at the task level, time tracking is used above that level. We noted also that project progress has been measured by the delivery of some significant intermediate products, for example, the new corporate tax forms, the revenue ledger and standardized accounting for scanning and imaging. The Secretariat's EMF is being applied to all new projects.

32.215 Strategis. The Strategis project at Industry Canada has made significant progress in implementing all components of our recommendation. Client surveys are being done four times a year to get information and feedback on services. Project planning has been improved and business cases for new services are used to set priorities for implementation, as was the practice in phase 1. A quality assurance (Q/A) function has been established and is involved in each project from start to finish. The Strategis Content and Product Committee, chaired by the head of Q/A, reviews the business cases and project charter information. This committee monitors each project as it proceeds through its implementation. Objective measures of progress have been introduced, including time tracking to

The Treasury Board Secretariat has recently set up a Web site for contributors to facilitate sharing. At the site, departments can post their plans as well as lessons learned, suggestions for further action, plan updates and other topical items. A Web site that is open to the public has also been created.

supplement subjective assessments. Strategis continues to innovate by improving its development processes as described above, by renovating its Strategis Web site as new features and facilities become available, and by exploring new Web-based services, such as electronic transactions, for its users. Although innovation in such fast-changing technology as the Web and the Internet

involves taking risks, the judicious use of feedback, learning, and tried and true methodologies can mitigate these risks. Industry Canada has told us that it uses the Secretariat's EMF for more traditional systems development projects, as well as selected best practices from the EMF for Strategis, its Web-based publishing operation.

Agriculture and Agri-Food Canada — Prairie Farm Rehabilitation Administration — 1997, Chapter 24

Assistant Auditor General: Don Young

Principal: Neil Maxwell

Background

32.216 The 1997 audit of the Prairie Farm Rehabilitation Administration (PFRA) revealed an organization with deep Western roots and a 70-year history of service to Canadians. It also found some significant problems. PFRA is the branch of Agriculture and Agri-Food Canada that is tasked with sustainable land and water management, as well as agricultural and rural development on the Prairies. Generally, we found that PFRA had not clarified its goals; nor had it identified and then prioritized issues so that activities could be properly planned and carried out. We made seven recommendations that addressed these problems and other issues related to cost recovery.

Scope

32.217 The objective of our 1999 follow-up was to determine the status of our 1997 recommendations, and to note any other significant matters that came to our attention.

Conclusion

32.218 We found that PFRA has taken seriously our primary observations on the need for greater strategic thinking and planning. The consensual approach that PFRA chose required time to permit proper “buy-in” from staff. Our findings revealed a change in work emphasis at PFRA and organizational commitment. What remains outstanding are the logical follow-through steps that should come out of this new thinking and approach, and action on some other specific recommendations.

32.219 To maintain credibility with its stakeholders, PFRA needs to fully implement the changes set out by its new strategy. The next steps for management entail realigning the organization and its resources. Although PFRA has begun determining the most cost-effective manner to deliver services, more work remains to change the organization’s resources to meet new challenges. PFRA has a long history of change and adaptation. The interests of stakeholders are intricately tied to how successfully PFRA positions itself for the future and efficiently runs its current and planned activities.

Observations

Land and water management issues are being defined and prioritized

32.220 The need to define and prioritize land and water management issues, along with the identification of required programming resources, was a main observation of our 1997 audit. Two years later, we found that PFRA has begun strategic planning in earnest by examining the current state of natural resources (water and land) and then evaluating emerging environmental issues, such as intensified agricultural production. Examples of this thinking include the Prairie Agricultural Landscape (PAL) project and the Hog Environmental Management Strategy (HEMS). Both projects demonstrate cross-prairie and long-term planning; issues are assessed with the aim of modifying existing policy or producing appropriate policy.

The Prairie Farm Rehabilitation Administration has taken seriously our primary observations of greater strategic thinking and planning.

Until recently, little reallocation or reassessment of resources had systematically occurred.

Geographical risk and assessment of needs are being built into programming

32.221 The need to implement prairie programming reflecting geographical expressions of risk and need was an important aspect of our 1997 audit. In our follow-up, we found that landscape risk and need were being identified and that PFRA was planning action. In addition to the Prairie Agricultural Landscape and the Hog Environmental Management Strategy, we have evidence of geographic priorities being set at the regional and district levels. For example, the Swift Current District Office is changing its work emphasis by addressing environmental risks posed by certain activities. Their work plan shows that activities will be tied to stated outcomes — for instance, they are developing a tool to assist with identifying areas where intensive livestock operations can be situated.

Delivery of sunset programming has been analyzed

32.222 We previously recommended to the Department that PFRA give careful consideration to the delivery of future sunset programs (namely, programs with a set time span or amount of funding). We cautioned the organization on the potential impact that sunset programs can have on core activities, and on the need to carefully gauge whether existing resources are sufficient to deliver both. In the past, PFRA had administered sunset programs that sometimes were not related to core work and diverted resources away from fundamental legislated duties. However, we found in our follow-up that new sunset programs have not been added to the workload of the organization. Management recognizes the risks associated with administering sunset programs and there is evidence that analysis of prospective sunset programming has been done.

No consistent regime of monitoring or inspection was found

32.223 The 1997 audit recommended implementing a consistent, cost-effective and risk-based program of monitoring and inspection. We had mentioned how the Permanent Cover Program, Rural Water Development Program, and shelterbelt program had different approaches relating to monitoring and inspection. Two years later, we found that this recommendation has not been fully addressed. No general evaluation of inspection across the organization has occurred. However, Agriculture and Agri-Food Canada is conducting a program evaluation that is expected to address monitoring and inspection issues in the Rural Water Development Program.

Reassessment of PFRA's resources is just beginning

32.224 An important observation that emerged from our previous audit was the need to reassess the geographic distribution and cost effectiveness of the current network of offices and resources. We stated that PFRA's offices and resources should reflect current conditions established through the evaluation of strategic issues, needs, and potential partners. As well, in its pledge to Parliament in 1998 following our audit, the Department stated, "resources will be reallocated as the PFRA changes its priorities and objectives." Although some resource reallocation has occurred, our follow-up audit found that until recently, little reallocation or reassessment had systematically occurred to match new planning. The rationale provided by PFRA is that this was consistent with its measured approach to change; accordingly, the necessary groundwork preceding such an assessment now exists. Evaluating the effectiveness of the current network of offices and resources is a contentious and difficult endeavour — but also a necessary one. Ultimately, the interests of stakeholders and the public

depend on how efficiently PFRA offices (and resources) are situated, used and cost-evaluated.

There has been little change in cost recovery from two years ago

32.225 In 1997 we recommended that PFRA identify the most cost-effective manner to deliver services and determine the optimum mix of cost recovery, cost sharing, and revenue generation. Our recent audit of user charges in the agriculture portfolio also identified that the Department needs to improve its management and use of user charges.

32.226 Based on our findings, we concluded that while PFRA's previous strengths in the area of cost recovery have continued, the organization has not fully addressed our 1997 findings. The strengths still existing at PFRA include good communication with people charged fees, ties to sustainable development, fees that tend to be market-priced and assurance by PFRA that financial controls are in place. In addition, we found that the Branch is putting in place necessary systems to allow it to track costs that could be recovered. However, we still found significant problems, such as the following three examples:

- There was little evidence of cost recovery being incorporated into strategic planning with ties to higher-level departmental goals. Existing cost recovery regimes, such as the community pastures program, tend to remain the organization's focus. Although not at the implementation (or program) stage, the development of major new efforts such as the Hog Environmental Management Strategy, did not include an early analysis of the

appropriateness of applying user charges and other aspects of cost recovery.

- Some parts of PFRA have endeavoured to incorporate cost recovery into annual work planning, while other sections have not. There is a lack of leadership on this issue. Regional offices feel ill prepared to deal with this complex and sometimes difficult area.

- PFRA does not yet collect and allocate costs and overhead for each of its current and prospective services and programs. As explained in our user charge audit, costing is one area where PFRA, like other organizations in the agriculture portfolio, still needs to improve.

A good start has been made in developing a performance measurement framework

32.227 The creation and use of performance frameworks are under way at all levels of the organization; these frameworks identify performance objectives, indicators and results for activities ranging from the project level to the Prairie-wide context. PFRA is progressing in its contribution to the Department's evolving Planning, Reporting and Accountability Structure (PRAS). The PRAS is part of the federal Expenditure Management System. This System relates to the internal management and accountability regime of departments; it ties together departmental objectives, business lines, resource requirements and performance targets. It is intended to provide the basis for reporting in Business Plans and Estimates documents that go before Parliament and the public. Agriculture and Agri-Food Canada has identified PFRA as a "best example" of performance measuring within the Department.

There was little evidence of cost recovery being incorporated into strategic planning.

The Office of the Correctional Investigator — 1997, Chapter 33

Assistant Auditor General: Maria Barrados
Principal: Ronald Wolchuk

Background

32.228 Under the *Corrections and Conditional Release Act*, the Office of the Correctional Investigator is mandated to conduct investigations into the problems of offenders. The Correctional Investigator plays an important role in ensuring fairness for those inmates serving sentences in Canada's federal prisons.

The Correctional Investigator has taken steps to address many of our previous audit concerns.

32.229 The objective of our 1997 audit was to determine the extent to which the policies and procedures of the Office of the Correctional Investigator have enabled it to carry out its mandate effectively. We observed weaknesses in five areas: workload management, communications, operational policies and procedures, resolving systemic issues with Correctional Service, and reporting results. We concluded that while the practices of the Office of the Correctional Investigator were often helpful in resolving individual complaints, they were not efficient and consistent, and had contributed, among other things, to an adversarial relationship with Correctional Service.

Scope

32.230 Our follow-up work included a review of the 1998 status report prepared by the Correctional Investigator for the Standing Committee on Public Accounts on the progress made in relation to our 1997 audit recommendations. We conducted interviews with officials of the Office of the Correctional Investigator and Correctional Service. We also reviewed supporting documentation.

Conclusion

32.231 Over the past two years, the Office of the Correctional Investigator has taken steps to address many of our previous audit concerns. The Office has undertaken initiatives in such areas as reducing the overlap between its complaint procedure and Correctional Service grievance process, implementing a formal policy and procedures, and establishing a more effective process for working with Correctional Service and resolving systemic issues.

32.232 However, further progress is required in some other areas. For example, work remains to be done in further developing the management information system, reporting results and implementing the communications action plan. It is essential that the Office implement the applicable recommendations related to these areas.

Observations

Managing the workload

32.233 In December 1997, we noted that the Office was experiencing difficulties managing its workload. We indicated that there were three contributing factors: excessive overlap between the Office's complaint process and Correctional Service's inmate grievance process; the lack of formal procedures and guidelines to assist investigators in determining how to most efficiently and effectively handle inmate complaints; and the overall size of the Office's workload.

32.234 Officials from both organizations have indicated that there is now less overlap between the Correctional Investigator complaint process and

Correctional Service inmate grievance process. The Office continues to reinforce an internal policy that, under normal circumstances, investigators should not initiate an investigation when the same complaint is still being examined within the Correctional Service's inmate grievance process. In addition, the Office has worked with Correctional Service to improve the inmate grievance process in such areas as timeliness and the use of lessons learned from upheld grievances in its management decisions.

32.235 In the past, investigators lacked clear guidelines concerning which cases to investigate and the level of effort to invest given the case circumstances. As a first step, the Office has provided its investigators with a new, approved policy and procedures manual to assist in differentiating between the requirements for an inmate contact, an inquiry and an investigation. This can potentially reduce the level of work required per inmate concern and thus further facilitate overall workload management.

32.236 Our 1997 Report indicated that the demand for the services of the Correctional Investigator was incessant and that both the demand and complexity of issues involved have increased in recent years. The number of individual complaints reported by the Correctional Investigator in his annual report has decreased significantly from about 6,800 (1995–96) to 4,500 (1998–99). However, Office management has indicated that during 1998–99, more time was dedicated to other tasks such as review of the *Corrections and Conditional Release Act*, review of Correctional Service Canada policy and procedures, and increased complexity of issues associated with women and Aboriginal inmates. There is now also the ongoing requirement that all videotapes and supporting documentation on Emergency Response Team Interventions and Use of Force be forwarded to the Office for review. During 1996–97, the Office received

videotapes and supporting documentation for 23 incidents. The following year, the number increased to 198, and for 1998–99, the number was 214. Investigators also estimate that the new Case Tracking System will require more detailed information input that, over the short term, will increase the time required to process each case.

Communication strategy

32.237 We indicated two years ago that it was important for an ombudsman such as the Correctional Investigator to ensure that his service is well known, understood and accessible. *The Corrections and Conditional Release Act* directs the Correctional Investigator to maintain a program outlining his function and role.

32.238 Interviews with officials from the Office and Correctional Service indicate that both inmates and Correctional Service staff still misunderstand the role of the Office. Their recent meetings with inmate committees and outside stakeholders have reinforced this observation.

32.239 To address this concern, the Office has designed a poster and brochure for future distribution to all institutions and parole offices. The task has not yet been completed. Work continues on editing the content of these documents as well as acquiring a toll-free telephone number to facilitate inmate access to the Office.

Resolving systemic issues

32.240 In 1997, we reported that there had been a long-standing adversarial relationship between the Office of the Correctional Investigator and Correctional Service. Disagreement concerning Correctional Service's position on certain systemic issues raised by the Correctional Investigator had eroded the level of effective co-operation. We recommended that both parties establish a more effective process for resolving and disposing of these issues.

Inmates and
Correctional Service
staff still
misunderstand the
role of the Office
of the Correctional
Investigator.

Implementation of the new policy and procedures manual of the Office of the Correctional Investigator was a first major step toward handling inmate problems and reporting results in a consistent manner.

32.241 Over the past two years, officials from the two agencies have worked together to develop a memorandum of understanding that provides a structure for interaction between the two parties for dealing with investigations and resolving issues. Key sections of this document include a description of the role of the Office of the Correctional Investigator, the process for communications, parameters for closure of investigations, and a non-binding dispute resolution mechanism.

32.242 We understand that both the Correctional Investigator and the Commissioner of the Correctional Service have agreed to the memorandum and are expected to sign it later this year.

Complaint investigation policies and procedures

32.243 In our 1997 chapter, we expressed concern that the Office did not provide its investigators with the necessary guidelines to assess an inmate concern, and determine the need for an investigation and how it should be conducted. From our file review at the time, we were unable to determine when and how the Office had decided to investigate and what the investigation entailed. We concluded that there was a risk that similar inmate problems were being handled inconsistently.

32.244 By the end of 1998, the Office had implemented an approved policy and procedure manual and briefed all staff. The manual was a first major step toward handling inmate problems and reporting Office performance results in a consistent manner. As part of the new manual, the Office plans to implement its designed quality control regime in the fall of 1999 to ascertain the level of investigator compliance with approved policy.

32.245 The Office is now proceeding with further improvements and enhancements that will build on the progress already made. Using the content

of the manual, the Office is creating two needed by-products: a more readable policy and procedure manual for investigators; and better-quality information on its existing Internet Web site for external stakeholders.

32.246 We also noted in 1997 that the Correctional Investigator lacked procedures that could help flag systemic issues. Both the existing procedures manual and future planned revisions will address part of this concern. Investigators will also need an approved summary of the Office's publicly stated position on recurring inmate issues. If provided, this will ensure that investigators communicate the same policy position for each recurring systemic issue to all stakeholders.

Reporting results

32.247 We also expressed concerns regarding the ability of the Office to provide accurate information and relevant performance measures both for management purposes and for its annual report to Parliament. Of primary concern was the management information system and its inability to acquire and track individual inmate complaint information and report overall Office performance.

32.248 In April 1999, the Office implemented a new management information database, designed to support its new policy and procedures manual. Historical data have been downloaded and the system is functional. However, consistent and timely new data input by investigators is still a challenge. More work is now required to integrate the system with its hardcopy files and operational requirements. The new system also has an audit capability to assure data input quality and compliance with approved procedures. This capability will not be tested until the fall of 1999.

32.249 The new system must have the capability in the future to report results in terms of contacts, inquiries and the disposition of investigations as proposed

in Exhibit 33.5, 1997. Currently, the database has not evolved sufficiently to be able to provide such performance information. The next phase of the planned system development will involve

identifying performance reporting needs and building the capability for the Correctional Investigator's annual report in 2000.

RCMP Public Complaints Commission — 1997, Chapter 34

*Assistant Auditor General: Maria Barrados
Principal: Ronald Wolchuk*

The RCMP Public Complaints Commission has taken steps to address several of our previous audit concerns.

Background

32.250 The RCMP Public Complaints Commission was established by the *RCMP Act* to ensure that members of the RCMP, who are given special authority and power under the law, are properly accountable to the public for their conduct. The Commission exercises its mandate by receiving complaints from the public and providing external and independent review, investigation and hearing of those complaints.

32.251 The purpose of our 1997 audit was to determine whether the Commission had adequately organized itself to discharge its mandate. The audit focussed on such areas as planning, communications, the review process, terms of reference and member training for public hearings, management information systems and reporting of results. We concluded that while the Commission had established systems and practices to fulfil its mandate, a number of areas in the Commission's management practices needed to be strengthened: communications strategy; action plans for the Commission's review process and public hearings; and performance reporting.

Scope

32.252 Our follow-up work included a review of the 1998 status report prepared by the Commission for the Standing Committee on Public Accounts on the progress made in relation to Chapter 34, 1997 audit recommendations. We conducted interviews with officials of the Commission, the Royal Canadian Mounted Police and the Solicitor General

Canada. We also reviewed supporting documentation.

Conclusion

32.253 The RCMP Public Complaints Commission has taken steps to address several of our previous audit concerns. The Commission has undertaken initiatives in such areas as processing a large number of backlog cases, streamlining its complaint review procedures and providing training to Commission members engaged in public hearings.

32.254 However, further improvements are still required in important areas. Although the Commission has processed an increased number of complaints, a large backlog of 400 cases remains. The Commission now needs to eliminate this backlog and achieve its revised turnaround standard for processing complaints, as planned by 2001.

32.255 In addition, the Commission needs to restructure its management information system with a view to ensuring reliable data quality and an enhanced ability to report its results annually to Parliament.

Observations

Communications strategy

32.256 In December 1997, our audit found that the Commission did not have a communications strategy that defined its role and that would increase public awareness of its existence as well as its independence from the RCMP. One study at the time found that the inclusion of "RCMP" at the beginning of its name invited a public perception that the Commission was part of the RCMP.

32.257 The Commission has still not approved a long-awaited communications strategy and plan. However, public awareness of its role was heightened greatly by the recent Public Interest Hearing into the conduct of RCMP officers at the Asia Pacific Economic Co-operation (APEC) conference at the University of British Columbia in November 1997.

32.258 Commission officials expressed that they still need to communicate their role better, particularly in small communities, with natives and visible minorities. They indicated that they will hire a communications officer whose first task will be to develop a communications plan for implementation in early 2000.

Streamlining the review process

32.259 We noted two years ago that the Commission's complaint review process was slow. The average turnaround time to complete a review significantly exceeded the Commission's own standard of 120 days. As a result, the backlog continued to increase to about 400 cases in 1997.

32.260 The Commission has recently streamlined its review process in three key areas: simplifying the quality control phase of its review process; making some critical policy changes to ensure that each review is better focussed and managed; and implementing administrative changes such as simplifying letters and reports. During the 1998–99 fiscal year, the Commission had completed about 350 of its 500 backlogged cases. This was the first time that it had processed more complaints than it received (260 complaints) during the same time period.

32.261 Currently, the Commission has an inventory of about 400 outstanding complaints. It has targeted March 2001 to eliminate the entire backlog and implement fully its 120-day case turnaround standard.

Public hearings

32.262 In our 1997 chapter, we reported that the Commission needed to significantly improve the way it carried out public hearings, both by prescribing precise terms of reference for each hearing and by providing its members with training in conducting hearings.

32.263 In order to provide a sharper focus to its public hearings, the Commission included written terms of reference in its Notice for the November 1997 APEC Public Interest Hearing. The Commission has indicated that it intends to repeat this practice for all future public hearings.

32.264 Most of the current members have received public hearing training over the past year and a half from one or more of the following sources: a conference on the basics of tribunal management; a workshop concerning current issues in public hearings; and a one-week training program in administrative tribunals. The Commission is currently developing an in-house training program that, among other things, will address critical and emerging issues related to public hearings.

Measuring and reporting results

32.265 We also had concerns in 1997 about both the accuracy of information contained in the Commission's Case Tracking System as well as the ability of the Commission to measure and report relevant results concerning its performance. Data quality still needs improvement and the Commission has not yet strengthened its ability to generate useful performance reports from its database.

32.266 In 1999, the Commission implemented a new management information system. Data quality remains a concern as some old case records have not yet been converted to the new system and, in some instances, are incomplete or of poor quality. In addition, the Commission has not yet undertaken a

The RCMP Public Complaints Commission has recently streamlined its review process.

The Commission has not yet strengthened its ability to generate useful performance reports.

review of system data quality against actual file documentation. Staff will not be trained on the new system until priorities such as improving the speed of data input from the Commission's remote site (Surrey, British Columbia) and installing a reporting capacity have been met.

32.267 At present, a report-generating capacity for the new system has not been designed. Performance reports on matters such as case turnaround time are still prepared manually. Commission officials have indicated that they will not adjust how they report results in their annual report until the reporting component has been installed in the new system. The

Commission expects to be able to provide enhanced performance information in its 1999–2000 annual report.

32.268 We also recommended two years ago that the Commission develop better measures of turnaround time for its reviews. At that time, the Commission was not calculating turnaround from when it received the request for review but rather from when the required documentation arrived from the RCMP. We stated that it would be more reasonable from both the complainant's and the RCMP member's perspectives to calculate time from when the Commission received the initial request for review.

Chapter 33

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Other Audit Observations

Main Points

33.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

33.2 The “Other Audit Observations” chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments, or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

33.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

33.4 Observations reported this year cover the following:

- secret commissions/kickbacks for refueling military vehicles;
- the lack of financial control and management systems at CORCAN; and
- the Employment Insurance Account surplus.

33.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Introduction

33.6 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

33.7 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue, and to ensure that expenditures have been made only as authorized;

- money has been expended other than for purposes for which it was appropriated by Parliament;

- money has been expended without due regard to economy or efficiency;

- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

- money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

33.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.

This chapter contains a number of observations on matters of significance not included elsewhere in the Report.

National Defence

*Assistant Auditor General: Jean Ste-Marie
Director: Neil J. Papineau*

Secret commissions/kickbacks for refueling military vehicles

Some National Defence military and civilian personnel have been accepting secret commissions/kickbacks from retail service stations for purchasing diesel fuel for military vehicles. At the time of our audit, this abusive practice had been taking place for at least two years.

Background

33.9 As a result of the Treasury Board decision to privatize the Fleet Management Information and Government of Canada Credit Card Services, Public Works and Government Services Canada (PWGSC) was tasked with issuing standing offers with private sector firms to assist departments in the management of their vehicle fleets.

33.10 A National Master Standing Offer (NMSO) was issued to a fleet management services company on 15 December 1993 to cover the period from 1 April 1994 to 31 March 1999. The standing offer has been extended to 31 March 2000. The use of this standing offer by departments is optional. Departments can call up against the fleet management services standing offer or they can contract on their own with any of the other fleet management companies.

33.11 The services provided under this standing offer include a service card-based system (credit card) and fleet management information services. This system permits departments to benefit from the government's tax exemptions and discounts through standing offers established by PWGSC with the major fuel companies, tire and tube manufacturers, vehicle manufacturers and vehicle repair and maintenance suppliers. Other services provided under the

standing offer include maintenance management, data management, consolidated billing and payment, fleet management assistance and any combination of the above.

33.12 There are approximately 21,000 retail outlets participating in the support of this standing offer agreement. Currently, approximately 4,100 vehicle fleet credit cards are issued to the Department of National Defence (DND) and 17,100 in total to the federal government.

33.13 National Defence obtains fuel for its military vehicles either at fueling depots on the DND military bases or off the military bases at numerous retail service stations (gas stations) across Canada. When DND military and civilian personnel refuel off the military bases, they usually pay for their purchases using vehicle fleet credit cards issued per the National Master Standing Offer referred to above.

33.14 National Defence diesel purchases at the retail service stations through this NMSO totalled \$1,518,000 in 1997–98 and \$2,117,000 in 1998–99.

33.15 DND does not centrally co-ordinate the issuance of these vehicle fleet credit cards. All responsibility for these cards has been devolved to the individual military bases and each military

base decides whether it will use such cards.

Scope

33.16 The Office of the Auditor General received a complaint alleging that DND military personnel were receiving cash rebates for refueling military vehicles with diesel fuel. As a result of this complaint, the Office undertook to examine the DND diesel fuel purchases for 1997–98 and 1998–99.

33.17 The scope of our examination was limited to a review of a small sample of retail service stations in two provinces and a small number of DND bases. This review included examining departmental and third party records in detail and interviewing departmental and private sector parties. Our review was confined to examining purchases of diesel fuel using vehicle fleet credit cards and did not look at general purchases using other types of credit cards. The findings in this audit are the results of this limited review.

Issues

33.18 Our review of National Defence purchases of diesel fuel from retail service stations determined that numerous cash rebates were made to some DND military and civilian personnel by retail service stations. Cash rebates had been made during the 1997–98 and 1998–99 fiscal years and the practice was still ongoing at the time of our review.

33.19 In our view, these cash rebates constitute secret commissions/kickbacks. Secret commissions are generally defined as the giving or receiving of a thing of value to an agent to influence a business decision without the knowledge or consent of the principal. Kickbacks are a type of secret commission that usually involve an overbilling scheme. They almost always involve a purchasing function of an organization and usually involve employees with purchasing responsibilities. With reference to this

matter, the agent is the employees and the principal is the Crown.

33.20 From the review of our sample of retail service stations in two provinces, over 200 DND military and civilian personnel have accepted cash rebates from retail service stations during the 1997–98 and 1998–99 fiscal years. Military and civilian personnel from 18 of a total 22 military bases have been accepting these cash rebates. The military bases involved are from the three Commands: Maritime Command, Land Force Command and Air Command.

33.21 The amount of the cash rebate varied, depending on the quantity of diesel fuel purchased and the rebate rate offered by the individual retail service stations. The stations offered various rebate rates of two cents to five cents per litre of diesel fuel. Cash rebates varied from \$4 to over \$70 per vehicle refueled. Though the individual cash rebate payment is not large, the cumulative total nationally could be substantial over the years. The amount of cash rebates determined from our sample was \$15,600 for diesel fuel purchases totalling \$216,700.

33.22 We found that some retail service stations inflated the diesel fuel price per litre to DND above the normal selling price to pay for the cash rebates. In addition, one of those stations inflated the price further to charge an administration fee for paying the cash rebates. Therefore, prices for diesel fuel were inflated by some retail service stations from five to nine cents a litre above their normal selling price.

33.23 Our review determined that diesel cash rebates were accepted by DND military and civilian personnel for 763 out of a total of 861 diesel fuel purchases where sufficient quantity was purchased to warrant a cash rebate. Therefore, diesel cash rebates were accepted 88 percent of the time when available to DND military and civilian personnel. Where a cash rebate was not accepted, the rebate amount was sometimes deducted from the

In our view, these cash rebates constitute secret commissions/kickbacks.

Individuals from three other federal departments and one Crown corporation were also accepting diesel fuel cash rebates.

We are concerned about the ethical conduct of some DND military and civilian personnel.

vehicle fleet credit card charge to reflect a reduction of the cost of diesel fuel purchased. We found only 40 incidents where the rebate amount was deducted from the diesel fuel charges on the credit card receipts. These 40 incidents were handled in an acceptable way for dealing with diesel fuel rebates, that is, reducing the amount charged on the vehicle fleet credit cards and thereby reducing the total fuel costs to the Crown. Retail service station personnel advised us that it was an industry practice to make cash rebate payments to truck drivers for diesel fuel purchases.

33.24 Although our limited sample of retail service stations was directed at DND, our review uncovered that individuals from three other federal government departments and one Crown corporation were also accepting diesel cash rebates for refueling government vehicles, using vehicle fleet credit cards. We found that the extent of the cash rebate practice involving these other government entities was small.

33.25 The acceptance of cash rebates by DND military and civilian personnel and employees of other departments contravenes the Treasury Board Travel Directive, which states, “Should a benefit be awarded to an employee, it shall immediately become the property of the Crown unless the benefit was awarded as the result of a program sanctioned by the Treasury Board.” These cash rebates are also in contravention of the Treasury Board Policy on Conflict of Interest and Post-employment Code. One of the principles of that policy is “employees shall not solicit or accept transfers of economic benefit, other than incidental gifts, customary hospitality, or other benefits of nominal value, unless the transfer is pursuant to an enforceable contract or property right of the employee.” Furthermore, the acceptance of cash rebates is not in accordance with the *Financial Administration Act* and, in regard to DND personnel, it is not in

accordance with the *National Defence Act*.

33.26 National Defence Headquarters was not aware of which military bases used these vehicle fleet credit cards; nor was it monitoring the extent of use. DND has national guidelines on the restrictions and obligations imposed on the transportation officers or users of vehicle fleet credit cards. DND military and civilian personnel responsible for vehicle fleet credit cards at some DND bases were not aware of these guidelines.

33.27 Our review of the military bases determined that the controls and authorizations at each military base for vehicle fleet credit cards varied substantially. Historical logs for custody of credit cards were not maintained at most military bases reviewed. In addition, monthly statements of the fleet management services company for fuel charges were paid by most DND military bases without adequately verifying whether all charges were incurred or appropriate.

33.28 We also determined that National Defence had received a similar complaint about diesel cash rebates being paid to DND military personnel prior to the Office of the Auditor General receiving a complaint. DND military police investigated the complaint but closed their investigation file as being unsubstantiated.

Conclusion

33.29 In our limited review, we found that a large number of DND military and civilian personnel from 18 military bases were involved in this abusive practice of accepting cash rebates for refueling military vehicles. This raises a serious issue — that is, the insufficiency of control measures in place to safeguard the Crown against the risks associated with these vehicle fleet credit cards. More important, we are concerned about the ethical conduct of DND military and

civilian personnel participating in this practice.

33.30 The participation of individuals from other departments and a Crown corporation in accepting cash rebates raises similar concerns.

National Defence's response: The Department of National Defence is currently not in a position to fully

corroborate the accuracy of the information provided in this Audit Note. However, the practice described in this report is not consistent with the values of the Department of National Defence and the Canadian Forces and we are committed to bringing it to an end. We are also committed to examining the adequacy of controls governing the use of vehicle fleet credit cards.

CORCAN – A Special Operating Agency of Correctional Service Canada

*Assistant Auditor General: Maria Barrados
Director: Amjad Saeed*

Lack of financial control and management systems at CORCAN

CORCAN needs to implement a full financial control and management system that would produce reliable and auditable financial statements as prescribed in its Charter.

Background

33.31 In 1992, Parliament approved the establishment of CORCAN, which provides work-related training and experience to offenders in institutions operated by Correctional Service Canada. It also provides employment-related services in the community to help offenders reintegrate into society upon their release. CORCAN operates in a businesslike manner, with total revenues of \$73 million in 1998–99 from the sale of goods and services in industries such as manufacturing, agriculture and construction.

33.32 CORCAN is designated as a special operating agency, that is, a unit within the traditional government structure that has been given additional administrative and financial flexibility to achieve specific, agreed-upon results.

33.33 When CORCAN became a special operating agency, Parliament authorized it access to a \$45 million revolving fund to be used for working capital, to acquire capital assets and to cover any operating losses. A revolving fund is a continuing or non-lapsing parliamentary appropriation.

33.34 At the same time, the Treasury Board approved a Charter outlining the accountability and reporting framework under which CORCAN was to operate.

The Charter includes, among other things, a description of the accounting, evaluation and audit functions. Under the accounting function, the Charter states that “CORCAN will ensure a full financial control and management accounting system providing for regular review of actual costs, revenues, operating performance and cash flows compared to budget. The accounting system will meet the standards established by the Treasury Board for the operation of a revolving fund.”

33.35 Treasury Board policies for accounting for revolving funds require that:

“As a minimum, the accounting system must provide for:

- the preparation and submission of both periodic and year-end data to the Receiver General on a modified cash basis of accounting in accordance with Receiver General directives to meet all requirements for keeping accounts as a budgetary appropriation; and
- the preparation of both periodic and year-end statements on an accrual and cost basis in accordance with private sector accounting practices.

The display and disclosure of assets and liabilities in the financial statements, as well as the method used to calculate depreciation, shall conform to generally

recognized accounting practices and shall be consistent from year to year."

Issues

Results of our recent audits of CORCAN

33.36 In 1996, we raised concerns that CORCAN was not meeting its goal of financial self-sustainability or its mandate to provide offenders with work-related training and experience. In April 1999, we reported that both these concerns were not adequately addressed. In addition, we noted that after six years of operations and receiving annually approximately \$18 million for training from Correctional Service Canada, CORCAN has reported accumulated losses totalling \$12 million. These losses, together with funds used to finance working capital needs and to acquire capital assets, have used \$32 million of the \$45 million revolving fund authority as at 31 March 1999. Since CORCAN reports that only about \$13 million remains in the revolving fund as at 31 March 1999, it is critically important that management have assurance that its financial management accounting system is generating accurate and reliable financial statements. This will assist in its decision making.

CORCAN's efforts to produce auditable financial statements

33.37 In the fall of 1996, CORCAN, with the assistance of Consulting and Audit Canada, took the initiative to engage an independent accounting firm to audit the 31 March 1997 financial statements. One year later, the firm formally communicated to CORCAN management its inability to express an unqualified audit opinion on those financial statements "due to pervasive problems within the reporting system and controls at CORCAN."

33.38 The firm identified several accounting deficiencies that CORCAN

would have to address in order to be in a position to receive an unqualified audit opinion on its annual financial statements. These deficiencies included inaccurate accounting for construction contracts and for capital assets, lack of control over accounts payable, and poor procedures related to the physical inventory count and valuation of livestock.

33.39 Due to CORCAN's inability to obtain an unqualified audit opinion as at 31 March 1997, management was advised by the accounting firm that CORCAN could benefit more by spending its time and effort in addressing these known deficiencies rather than proceeding to an audit.

33.40 Upon our request, CORCAN, with the assistance of the accounting firm, provided us with a status report to 15 October 1998 on the deficiencies identified in 1997. The report stated, "It is our intent to complete work on these issues by the end of this fiscal year and be able to have an independent audit of our 31 March 1999 financial statements."

33.41 Our follow-up of the issues in August 1999 revealed that draft reports on policies, procedures and internal controls for three CORCAN business lines and the corporate accounting function were prepared by the independent accounting firm. In these draft reports, the most significant findings related to the lack of an "overall control environment". The emphasis on management's "control consciousness" is the most critical condition for creating a positive atmosphere conducive to the effective operations of the accounting systems and controls. The draft reports also noted that a "significant leap" is required in order for CORCAN to undergo an independent audit in an efficient and effective manner.

Conclusion

33.42 In the seven years since Correctional Service Canada obtained authority to establish its prison industries

It is critically important that management have assurance that its financial management accounting system is generating accurate and reliable financial statements. This will assist in its decision making.

An accounting firm's audit reports noted that a "significant leap" is required in order for CORCAN to undergo an independent audit in an efficient and effective manner.

as a special operating agency with special powers and new authorities, CORCAN has not maintained a sound financial control and management accounting system that would produce reliable and auditable financial statements as prescribed in its Charter. The maintenance of such a system is critical for effective decision making and accountability. Taking our past and current concerns together, we believe that CORCAN has not adhered to either its Charter document or the policies for special operating agencies approved by the Treasury Board.

33.43 Subsequent to completion of our audit work, CORCAN's management informed us that CORCAN has recently completed a review of its accountability structure and of a sound management control framework and considers implementation of these as a prerequisite to maintaining a reliable and efficient financial control system and management accounting and reporting system. CORCAN believes that it will be in a position to receive a favourable audit opinion on its financial statements for the fiscal year ending 31 March 2001.

Human Resources Development Canada

*Assistant Auditor General: Maria Barrados
Director: Basil Zafiriou*

The Employment Insurance Account surplus

The *Employment Insurance Act* enjoins the Canada Employment Insurance Commission to set premium rates at levels that will cover program costs while remaining relatively stable over a business cycle. At the end of fiscal year 1999, the cumulative surplus in the Employment Insurance (EI) Account stood at \$21 billion, a level much higher than the Chief Actuary of Human Resources Development Canada considers sufficient for purposes of the EI Act. The Act does allow the Commission discretion in setting rates and establishing an appropriate level of reserves. However, to provide Parliament and the public with a better appreciation of how that discretion is being used, the Commission should explain the factors it relies upon to set premium rates and the EI Account reserve it considers necessary for purposes of the EI Act.

Background

33.44 The report of the Auditor General on the financial statements of the Employment Insurance (EI) Account for the year ended 31 March 1999 drew attention to the fact that the surplus of the Account had grown during the year by \$7.3 billion, to \$21 billion (see Exhibit 33.1). At this level, the surplus in the Account was much higher than the Chief Actuary of Human Resources Development Canada (HRDC) considers sufficient for purposes of the *Employment Insurance Act*, under which the Account has been established. The reason for drawing attention to this matter is that the size of the surplus and its rate of growth raise questions about the factors that the Canada Employment Insurance Commission relies upon in setting premium rates and determining the level of reserves it considers necessary for purposes of the *Employment Insurance Act*.

Issues

The size of the surplus

33.45 Section 66 of the *Employment Insurance Act* requires the Canada Employment Insurance Commission to set employment insurance premiums at a rate that it considers will, to the extent possible, ensure enough revenue to cover EI Account payments and maintain relatively stable rate levels over the business cycle. The rate set by the Commission (which is composed of representatives of employees, employers and the government) must be approved by the Governor in Council at the recommendation of the ministers of Human Resources Development and of Finance.

33.46 The Chief Actuary of HRDC has estimated that a reserve of \$10 billion to \$15 billion (attained just before a downturn) should be sufficient to guarantee stability of the rates over the

business cycle. Further, the Chief Actuary has estimated that an employee premium rate between 1.90 and 2.10 percent of insurable earnings would meet the costs of the EI program over the long term.

33.47 The employee premium rate for 1999 was set at 2.55 percent (and 1.4 times that, or 3.57 percent, for the

employer premium). At the existing premium rate, the cumulative surplus in the EI Account will likely exceed \$26 billion by the end of the current fiscal year. The cumulative surplus in the EI Account is already considerably larger than the amount the HRDC Chief Actuary considers sufficient to satisfy the requirements of the EI Act. And the

Exhibit 33.1

Employment Insurance
Account
1999 Auditor's Report



AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister of Human Resources Development

I have audited the balance sheet of the Employment Insurance Account as at March 31, 1999 and the statement of operations and surplus for the year then ended. These financial statements are the responsibility of the management of the Canada Employment Insurance Commission. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Employment Insurance Account as at March 31, 1999 and the results of its operations and its cash flows for the year ended in accordance with the accounting policies set out in Note 2 to the financial statements.

I wish to draw to your attention that the surplus of the Employment Insurance Account has increased during the current year by \$7.3 billion, to \$21 billion. Under the Employment Insurance Act, and as described in Note 5 to the financial statements, premium rates should be established at a level sufficient to ensure that there will be enough revenue over a business cycle to pay the amounts authorized, while maintaining relatively stable rates throughout the cycle. The Act does not define the level of surplus or reserve deemed sufficient to meet the objective. However, according to a report by the Chief Actuary of the Department of Human Resources Development on employment insurance premium rates for 1999, a reserve of between \$10 and \$15 billion, attained just before an economic downturn, should allow meeting all additional costs during the period of decline. In my opinion, in view of the current level of the surplus, clarification and disclosure of the factors to be used in determining an appropriate level of reserve are necessary.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 23, 1999

surplus can be expected to continue growing as long as the premium rate exceeds the rate that the Chief Actuary deems sufficient to cover the ongoing costs of the EI program.

33.48 The legislative provisions relating to setting premium rates are not very precise. The expressions “enough revenue” and “relatively stable rate levels” are not defined in the Act. This ambiguity is compounded by the requirement that rate stability be established with reference to the “business cycle”. While the term “business cycle” may have a clear meaning in economics, the length and amplitude of business cycles are not predictable with certainty. Thus, the law as it now reads gives the Employment Insurance Commission considerable discretion in setting EI premium rates and determining the appropriate level of EI reserves. That discretion must be exercised within the process of consultation, recommendation and approval outlined in paragraph 33.45.

33.49 However, if meaning is to be attached to the *Employment Insurance Act*, the discretion used in setting rates cannot be unlimited. Employment insurance revenues are collected in order to finance activities sanctioned under the Act; and there must be some level of reserves that suffices for that purpose. The HRDC Chief Actuary has advised the Commission that a level of \$15 billion (attained just before the onset of a recession) should suffice. The level now is substantially higher than that — and rising.

33.50 The Chief Actuary’s estimates are based on calculations and assumptions that are clearly set out in his annual report to the Employment Insurance Commission. Although the Commission has no obligation to accept the advice of the Chief Actuary, we believe that if it disagrees with the Actuary’s estimates, it ought to explain why. If it has other factors that it considers in setting rates, it

should explain those also. Otherwise, Parliament and the public are left to speculate about the factors driving decisions concerning one of the government’s largest and most visible programs.

Impacts on the government’s financial statements

33.51 The rate at which EI premiums are set has important consequences for the government’s financial statements overall. Since 1986, the EI Account has been consolidated in the government’s Summary Financial Statements. This treatment conforms with CICA (Canadian Institute for Chartered Accountants) standards concerning the accounting for activities closely controlled by governments, and parallels the treatment accorded similar other special purpose accounts and Crown corporations.

33.52 Consolidation means that surpluses or deficits in the EI Account have a direct impact on the government’s budgetary balance. For example, had other things remained unchanged, in the absence of the \$7.3 billion EI surplus for 1998–99, the government would have recorded a \$4.4 billion deficit, rather than the realized \$2.9 billion surplus. Similarly, in the absence of the \$21 billion EI reserve, the federal government’s net debt would have been \$598 billion at 31 March 1999, rather than the reported \$577 billion.

The current surplus in the Employment Insurance Account significantly exceeds the amount the Chief Actuary of Human Resources Development Canada considers sufficient to keep premiums stable over time.

Conclusion

33.53 The *Employment Insurance Act* enjoins the Canada Employment Insurance Commission to set premium rates at levels that will cover program costs while remaining relatively stable over a business cycle. The current surplus in the EI Account significantly exceeds the amount the HRDC Chief Actuary considers sufficient to keep premiums stable over time, at a level that will meet authorized program costs. Legislation does allow the Commission discretion in

setting rates and establishing an appropriate level of reserves. However, to provide Parliament and the public with a better appreciation of how that discretion is being used, we believe the Commission should explain the factors it relies upon to set premium rates and determine the EI Account reserve it considers necessary for purposes of the EI Act.

Human Resources Development Canada's response: Employment insurance (EI) premium rates are set in keeping with the process set out in Section 66 of the Employment Insurance Act using the analysis supplied by the Chief

Actuary. The Canada Employment Insurance Commission sets the premium rate each year with the approval of the Governor in Council on the recommendation of the ministers of Human Resources Development and of Finance. The Commission is made up of representatives of workers, business and government. Each year they attempt to reconcile their varying perspectives in the goal of reaching a unanimous position. For each of the last three years, they have successfully reached a consensus on the EI premium rate. This has resulted in lower EI premiums in each of those years.

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APPENDIX A

AUDITOR GENERAL ACT

R.S.C., c. A-17

An Act respecting the Office of the Auditor General of Canada and
sustainable development monitoring and reporting
1995, c. 43, s.1.

SHORT TITLE

Short title 1. This Act may be cited as the *Auditor General Act*. 1976-77, c. 34, s.1.

INTERPRETATION

Definitions	2. In this Act,
“appropriate Minister”	“appropriate Minister” has the meaning assigned by section 2 of the <i>Financial Administration Act</i> ;
“Auditor General”	“Auditor General” means the Auditor General of Canada appointed pursuant to subsection 3(1);
“category I department”	“category I department” means <ul style="list-style-type: none">(a) any department named in Schedule I to the <i>Financial Administration Act</i>,(b) any department in respect of which a direction has been made under subsection 24(3), and(c) any department, as defined in the <i>Financial Administration Act</i>, set out in the schedule;
“Commissioner”	“Commissioner” means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);
“Crown corporation”	“Crown corporation” has the meaning assigned to that expression by section 83 of the <i>Financial Administration Act</i> ;
“department”	“department” has the meaning assigned to that term by section 2 of the <i>Financial Administration Act</i> ;
“registrar”	“registrar” means the Bank of Canada and a registrar appointed under Part IV of the <i>Financial Administration Act</i> ;
“sustainable development”	“sustainable development” means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;
“sustainable development strategy”	“sustainable development strategy”, with respect to a category I department, means the department’s objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office 3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem	(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.
Re-appointment	(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.
Vacancy	(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.
Salary	4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.
Pension benefits	(2) The provisions of the <i>Public Service Superannuation Act</i> , other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the <i>Diplomatic Service (Special) Superannuation Act</i> in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the <i>Public Service Superannuation Act</i> do not apply to him. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

DUTIES

Examination	5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976-77, c. 34, s. 5.
Idem	6. The Auditor General shall examine the several financial statements required by section 64 of the <i>Financial Administration Act</i> to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.
Annual and additional reports to the House of Commons	7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons <ul style="list-style-type: none"> (a) on the work of his office; and, (b) on whether, in carrying on the work of his office, he received all the information and explanations he required. (2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that <ul style="list-style-type: none"> (a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

- (b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- (c) money has been expended other than for purposes for which it was appropriated by Parliament;
- (d) money has been expended without due regard to economy or efficiency;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

- (a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and
- (b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s. 9.

Improper retention
of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s. 12.

ACCESS TO INFORMATION

Access to
information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of
officers in
departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976-77, c. 34, s.13.

Reliance on audit
reports of Crown
corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General
may request
information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the
Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976-77, c. 34, s. 14.

STAFF OF THE AUDITOR GENERAL

- Officers, etc.**
- 15.** (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.
- Contract for professional services**
- (2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.
- Delegation to Auditor General**
- (3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.
- Suspension**
- (4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976-77, c. 34, s. 15; 1992, c. 54, s. 79.
- Appointment of Commissioner**
- 15.1** (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.
- Commissioner's duties**
- (2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.
- Responsibility for personnel management**
- 16.** In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976-77, c. 34, s.16.
- Classification standards**
- 17.** Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976-77, c. 34, s. 18.
- Delegation**
- 18.** The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s. 19.

ESTIMATES

- Estimates**
- 19.** (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.
- Special report**
- (2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s. 20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976-77, c. 34, s. 21.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 22.

SUSTAINABLE DEVELOPMENT

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

- (a) the integration of the environment and the economy;
- (b) protecting the health of Canadians;
- (c) protecting ecosystems;
- (d) meeting international obligations;
- (e) promoting equity;
- (f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
- (g) preventing pollution; and
- (h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond	(3) · · · The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within
	(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or
	(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.
Multiple petitioners	(4) Where the petition is from more than one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.
Duty to monitor	23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor
	(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and
	(b) the replies by Ministers required by subsection 22(3).
Commissioner's report	(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including
	(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;
	(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and
	(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).
Submission and tabling of report	(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.
Strategies to be tabled	24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons
	(a) within two years after this subsection comes into force; or
	(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).
Updated strategies to be tabled	(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

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| Governor in Council direction | (3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the <i>Financial Administration Act</i> , direct that the requirements of subsections (1) and (2) apply in respect of the department. |
| Date fixed by Governor in Council | (4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons. |
| Regulations | (5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5. |

APPENDIX B

FINANCIAL ADMINISTRATION ACT

R.S., c. F-11

Extracts from Part X

CROWN CORPORATIONS

Financial Management

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|-------------------------------------|---|
| Books and systems | 131. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly-owned subsidiaries, if any. |
| Idem | (2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively. |
| Internal audit | (3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost. |
| Financial statements | (4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any. |
| Form of financial statements | (5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary. |
| Regulations | (6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in |

respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit	(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.
Errors and omissions	133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.
Idem	(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.
Correction	(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.
Auditors	
Appointment of auditor	134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.
Auditor General	(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.
Idem	(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.
Exception	(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.
Criteria for appointment	(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).
Re-appointment	(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office	(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.
Persons not eligible	135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.
Independence	<p>(2) For the purpose of this section,</p> <ul style="list-style-type: none"> (a) independence is a question of fact; and (b) a person is deemed not to be independent if that person or any of his business partners <ul style="list-style-type: none"> (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates, (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or (iii) has been a receiver, receiver–manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.
Resignation	(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.
Qualifications preserved	136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re–appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re–appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.
Resignation	137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.
Special examination	Special Examination
Time for examination	<p>138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly–owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).</p> <p>(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.</p>

Plan	(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.
Resolution of disagreements	(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved <ul style="list-style-type: none"> (a) in the case of a parent Crown corporation, by the appropriate Minister; and (b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.
Reliance on internal audit	(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.
Report	139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.
Contents	(2) The report of an examiner under subsection (1) shall include <ul style="list-style-type: none"> (a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and (b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.
Special report of appropriate Minister	140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.
Special report to Parliament	141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.
Examiner	142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.
Idem	(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the

auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception (3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions (4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible (5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General 143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information 144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

- (a) information and explanations, and
- (b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem (2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

- (a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and
- (b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports (3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

- (a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;
 - (b) the objectives of the corporation; and
 - (c) any business or policy decision of the corporation or of the Government of Canada.
- 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

- (3) The audit committee of a parent Crown corporation shall
 - (a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;
 - (b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee	(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.
Form and contents	<p>(3) The annual report of a parent Crown corporation shall include</p> <ul style="list-style-type: none"> (a) the financial statements of the corporation referred to in section 131, (b) the annual auditor's report referred to in subsection 132(1), (c) a statement on the extent to which the corporation has met its objectives for the financial year, (d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and (e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,
	and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.
Idem	(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.
Annual consolidated report	151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.
Reference to committee	(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.
Contents	<p>(3) The annual consolidated report referred to in subsection (1) shall include</p> <ul style="list-style-type: none"> (a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation; (b) employment and financial data, including aggregate borrowings of parent Crown corporations; and (c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.
Annual report	152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the

summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

APPENDIX C

REPORT TO THE HOUSE

Wednesday, 21 October 1998

Federal Laboratories for Human and Animal Health Building Project

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SEVENTEENTH REPORT

The Standing Committee on Public Accounts studied Chapter 7 of the April 1998 Report of the Auditor General of Canada (*Federal Laboratories for Human and Animal Health Building Project*) and agreed to the following report:

Introduction

The new Federal Laboratories for Human and Animal Health in Winnipeg contain some of the most advanced diagnostic, research and training facilities of their kind in the world. The facility is the first in the world to combine laboratories concerned with both human and animal diseases, and the first in Canada capable of handling the most dangerous viruses known. The facility is to be used by Health Canada and the Canadian Food Inspection Agency.

The occupants are expected to take possession of the facilities in the fall of 1998, almost 11 years after the project was first proposed. In the opinion of the Office of the Auditor General (OAG), the project is approximately a year behind schedule and the estimated cost now stands at \$176 million, \$34 million more than the original estimate of \$142 million. Contrary to Treasury Board policy, the originally proposed budget did not identify all project costs.

The Office of the Auditor General identified several areas where Public Works and Government Services Canada, the contracting department and project authority, could improve its practices in selecting and managing consultants on future complex projects like this one.

With a view to answering these and many other questions, the Standing Committee on Public Accounts decided to study the Auditor General's findings and observations regarding the federal laboratories in Winnipeg. On June 4, 1998, the Committee met Denis Desautels, Auditor General of Canada, and Shahid Minto, Assistant Auditor General. Health Canada was represented by Robert S. Lafleur, Assistant Deputy Minister, Corporate Services Branch, and Dr. Joseph Z. Losos, Assistant Deputy Minister, Health Protection Branch. Dr. Norm Willis, Executive Director of the National Centre for Foreign Animal Disease in Winnipeg, testified on behalf of the Canadian Food Inspection Agency. Michael Nurse, Assistant Deputy Minister, Real Property Services Branch, and Bruce Lorimer, Director General, Architectural and Engineering Services, represented the Department of Public Works and Government Services Canada. Deputy Comptroller General Colin Potts appeared on behalf of the Treasury Board of Canada Secretariat.

Observations and Recommendations

The federal laboratory project in Winnipeg was officially launched in September 1987. The two client departments, Health Canada and Agriculture and Agri-Food Canada, submitted their documentation to Treasury Board to justify the construction of new facilities and the need for high-biosafety laboratories (level 4). The Auditor General's review confirmed that the two departments needed to upgrade and augment the existing facilities (7.38) in

order to carry out their mandated programs efficiently and effectively. The audit also confirmed that part of the new facilities in Winnipeg fulfilled a capacity and program need that could not be met in any existing laboratories in Canada. However, the Auditor General observed that, at the time the decision was made to construct the new facilities in Winnipeg, no in-depth analysis of each department's overall laboratory profile and capacity to meet current and future service and facility needs had been conducted.

In April 1996, Health Canada commissioned a study to assess current and future needs. The study did not take into account the capacity of the new facilities in Winnipeg even though they are considered a keystone of Health Canada's microbiological laboratory services and capacity. The study concluded that the department was spending significant amounts of maintenance dollars on what appeared to be excess laboratory capacity and recommended that a laboratory space optimization study be carried out (7.39). In the past, the departments had tended to overbuild laboratory capacity in anticipation of future growth which often did not materialize. In July 1997, the Canadian Food Inspection Agency (CFIA) set up a task force to assess its future laboratory and quarantine support service requirements. The objective is to develop options for reducing the cost of laboratories and quarantine inspections with minimal impact on service. The CFIA informed the Auditor General that the scope of the study had been enlarged to include a broader consideration of options. The Auditor General does not know when the study will be completed.

According to the Auditor General, the Winnipeg facility can accommodate significantly more than the number of scientists and support staff planned for occupancy. The Auditor General noted in his report that the Winnipeg facilities allocated approximately 100 net square metres per scientific staff member which is approximately double the national average (7.47). Also the building grew from 10,900 net square metres in 1991 to 13,000 net square metres in 1996, without any corresponding increases in program requirements (7.44). In his remarks before the Committee, the Auditor General said that 70 out of a total of 180 positions had yet to be filled, representing 40% of the staff that the client departments anticipate for the new laboratories in Winnipeg. At the end of the audit, the departments concerned still did not have an activities plan or a comprehensive strategy to ensure the full use of the Winnipeg facilities.

The issue of surplus capacity at the Winnipeg facilities, in particular the large number of still-vacant positions, was a major concern for the Committee members. They repeatedly asked the Health Canada representative, Dr. Joe Losos, what his department was planning to do to rectify the situation. Dr. Losos told the Committee that there is currently a memorandum of agreement between Health Canada and the CFIA regarding surplus capacity and that an activity plan for rationalizing the laboratory space (1605) is to be completed by late summer of this year. The Committee asked the witness about the fate of the existing facilities. Dr. Losos said he expected decommissioning of some of the existing facilities as staff and equipment move to the new laboratories in Winnipeg (1650). Finally, the Committee urged the Auditor General to review the activity plans of the departments concerned to ensure that they adequately addressed the issues raised in the meeting and convey its findings to the Committee. The Auditor General said he would be quite agreeable to review and comment on the departments' activity plans (1700). The witness for Health Canada, meanwhile, agreed to the Committee's request to report the Auditor General's findings on the activity plan the next time the department appeared before the Committee.

Based on the findings, the Committee recommends:

That Health Canada and the Canadian Food Inspection Agency take the capacity of the Winnipeg laboratories into account in their ongoing evaluation of their national laboratory needs;

That Health Canada and the Canadian Food Inspection Agency submit as soon as possible but no later than January 31, 1999, to the Standing Committee on Public Accounts, a concise letter describing the memoranda of agreement on measures to eliminate the surplus capacity;

That Health Canada and the Canadian Food Inspection Agency complete by March 31, 1999, their activity plans and strategies for phasing out the surplus capacity of the federal facilities in Winnipeg;

That Health Canada and the Canadian Food Inspection Agency implement their action plans, developed in response to the Auditor General's findings and observations, and report the implementation of their action plans to the Standing Committee of Public Accounts by March 31, 1999.

With regard to the management and financial control framework, the Committee took particular interest in the Auditor General's findings regarding the departmental "philosophy" of spending the entire approved budget (7.59 and 7.60) instead of seeking for potential savings. According to the Auditor General's recommendations, the Treasury Board Secretariat and the Department of Public Works should develop incentives to encourage underspending of budgets. In its response to the Auditor General's recommendations, the Secretariat said it does not believe that an incentive regime at the project level would be an effective way to encourage underspending of budgets. In the Secretariat's view, it would be difficult to envision an incentive regime that would not have a potential downside in the absence of a much more rigorous [Treasury Board] approval process than the one that is currently in place (7.61). On the other hand, Public Works and Government Services Canada (PWGSC) is currently identifying ways to introduce into the overall contracting process a viable and meaningful incentive system for reducing costs where feasible (7.62).

The Committee questioned the witnesses from the Treasury Board Secretariat and Public Works and Government Services Canada about the measures they were planning to undertake to correct or change this departmental philosophy. Mr. Colin Potts, Deputy Comptroller General with the Treasury Board Secretariat, responded by saying, "the Treasury Board Secretariat agrees that the aim should be to achieve the most cost-effective result. As reflected in government policy, we believe this can best be accomplished by establishing budgets through benefit, cost, and option analysis, and by managing projects to ensure that approved objectives are met within budget" (1600). The witness went on to say that the Secretariat has begun a complete overhaul of the procurement function of government with the aim at making procurement better and more efficient, with emphasis on planning, options and ensuring the best value for the dollar (1725).

The witness for Public Works and Government Services Canada, Mr. Michael Nurse, said that incentive-based payment clauses and issues related to "errors and omissions" have been added to the agenda of the task force of the Association of Consulting Engineers of Canada and the Royal Architectural Institute of Canada, with which the department meets regularly (1555). The Committee was surprised to learn about this lack of consensus between the department and its consultants regarding a clear definition of design "errors and omissions". The Committee was concerned that this fundamental definition remained unresolved.

The observations of the Auditor General and the witnesses lead the Committee to recommend:

That, for future capital projects, the Treasury Board Secretariat establish a more rigorous approval process that would introduce a project-based incentive regime aimed at saving money and rectifying the departmental philosophy of "building to budget";

That, for future capital projects, the Treasury Board Secretariat set up systems and procedures that will enable it to identify options for saving money in the overall budget when departmental submissions are reviewed;

That, for future capital projects, Public Works and Government Services Canada complete its consultations with its private-sector partners as quickly as possible so that it can integrate viable incentives into its contracting process in order to reduce costs;

That, for future capital projects, Public Works and Government Services Canada complete its consultations with its private-sector partners as quickly as possible so that they can come to terms on a common definition of the concept of "errors and omissions";

That the Treasury Board Secretariat and Public Works and Government Services Canada report on the progress in these areas to the Standing Committee on Public Accounts by March 31, 1999 and annually thereafter in their Performance Reports to Parliament.

For a financial management and control system to work properly, budget estimates “need to be reviewed rigorously and challenged by senior managers and Treasury Board officials when approving projects” (7.52). For the Winnipeg laboratory project, the Auditor General noted that the preliminary budget was incomplete and subsequent increases were not well supported. In his report, the Auditor General stated that the \$142 million budget approved in August 1992 for the project did not include all the related costs, which, by the Auditor General’s current estimate, now totals \$176 million. (See exhibit 7.5) The Auditor General found that the precise nature and extent of activities intended to be financed by the budget were not made clear.

The Committee asked Mr. Colin Potts, Deputy Comptroller General with the Treasury Board Secretariat, about the budget increases. The witness replied that the procedure is to take the information submitted by departments in good faith, and there was no reason to question the information at the time it was submitted to the Treasury Board. In principle, the Treasury Board reviews the information and considerable discussion takes place between its analysts and the particular departments involved. The Committee then asked the witness about the measures the Treasury Board would have to take in order to ensure that such a situation would not arise again in the future. Mr. Potts acknowledged that the Treasury Board Secretariat would have to remind departments to provide it with full and accurate information and to talk to Treasury Board officials to ensure that the systems that are put in place provide complete budget information (1645). In light of this information, the Committee recommends:

That, for future capital projects, the Treasury Board Secretariat, before approving budget requests, conduct a rigorous and comprehensive review of all the budget information provided by the departments in order to ensure accuracy and completeness of budgetary data;

That, for future capital projects, the Treasury Board Secretariat ensures, as stipulated in its own directives, continuous monitoring of project status and requires the departments concerned to provide it with complete and accurate progress and cost reports, and that these reports be submitted to the Treasury Board Secretariat at regular intervals or when predetermined project milestones are reached.

In his report, the Auditor General noted several instances of non-compliance with Treasury Board policies: specifically, instances where Public Works exceeded its spending authority, and examples of inadequate reporting of progress and of project costs, all in violation of Treasury Board policies (7.65 and 7.66). The Committee asked the witness for Treasury Board, Mr. Colin Potts, why this non-compliance was tolerated and that no penalty was imposed. The Committee had noted the Auditor General’s observation that Treasury Board guidelines do not contain any provision for monitoring compliance with Treasury Board policies and guidelines (7.30). The Committee holds the view that it is not enough to have rules; provisions on monitoring and penalties are also needed to ensure that the rules are observed. The Committee therefore recommends:

That, for future capital projects, the Treasury Board Secretariat ensure the application of monitoring provisions for its guidelines and also ensure the consistent application of penalties in the event of non-compliance with policies and directives, and that it submit a full account of its progress in this area to the Standing Committee on Public Accounts by March 31, 1999 and annually thereafter in its Performance Report to Parliament.

The Auditor General noted several deficiencies in the project management and control framework for the Winnipeg laboratory project. The Committee focused on the absence of primary authority over the Project Steering Committee and of extremely high consulting costs.

The Project Steering Committee was responsible for the overall direction and conduct of the project. At the outset, it comprised three assistant deputy ministers, one from each of the client departments and one from Public

Works. In 1995, the Committee was enlarged from three to five assistant deputy ministers: two from Health Canada, one from Agriculture and Agri-Food Canada, one from the Canadian Food Inspection Agency and one from Public Works. The Auditor General further noted that, over the life of the project, 13 different members served on the Committee. A high turnover rate coupled with the need to make decisions by consensus slowed the decision-making process.

During the first few years of the project, the Project Steering Committee had difficulty preventing or resolving disagreements between the client departments. This lack of teamwork is partly to blame for cost overruns and construction delays on the project (7.80). The Auditor General added, however, that teamwork and cooperation improved significantly from mid-1995, when Health Canada reorganized its project management staff and approach (7.81).

The Committee members questioned Mr. Michael Nurse of Public Works about the lack of leadership within the team. Mr. Nurse replied that the project was very complex and difficult to coordinate, but the client departments did a fine job meeting their obligations considering the availability of information and the circumstances. He agreed, however, that from a learning point of view, it would be better to have a single primary authority to resolve disagreements between client departments (1615).

When questions were put to him, Mr. Colin Potts said that the role of the Treasury Board Secretariat is basically to ensure monitoring. Once the Treasury Board approves funding for a project, it is up to the respective client departments to implement management policies. Mr. Potts added, however, that the Treasury Board had put in place in 1994 a new policy requiring a single authority to represent the interests of all client departments (1645). Mr. Potts said that the new policy did not apply to the Winnipeg project because the construction of the facilities started in 1990–91. The Committee therefore recommends:

That, for future capital projects involving more than one client department, the Treasury Board Secretariat apply its new policy of designating a single authority to represent the interests of all client departments and that it be held accountable for the project results, in accordance with Treasury Board policies.

The Auditor General noted that the cost of consulting services totaled \$38.8 million, or 38% of construction costs. The report states that project officials agreed the costs were higher than expected and attributed the increase to several factors, such as programming and construction delays that required more on-site personnel for longer periods than planned and extensive travel by consultants between their offices and the project site (7.76). The Auditor General believes that departments should do more to ensure that consultant agreements are tailored to take into account contractual issues specific to the project (7.75). The Auditor General also noted that, throughout the Winnipeg project, there were contract disputes between Public Works and the prime consultants, and at times with sub-consultants, over issues that had not been set out clearly in the outset in the consultant agreement and which resulted in additional costs (7.75).

In response to questions from the Committee, the witness for Public Works and Government Services Canada, Mr. Michael Nurse, said that the cost of consulting services was reasonable for that particular project given its unique and complex nature. However, the Committee asked Mr. Shahid Minto, the Assistant Auditor General, for his opinion on this issue. Mr. Minto said that during the audit, the project managers themselves agreed that the consulting costs were far higher than projected (1715). Based on what it heard from the witnesses, the Committee recommends:

That, for future capital projects, Public Works and Government Services Canada ensure that agreements between it, the prime consultants and sub-consultants are tailored to the specific project needs, and that the department submit a full report on the progress of this issue to the Standing Committee on Public Accounts by March 31, 1999 and annually thereafter in its Performance Report to Parliament.

Conclusion

The Committee recognizes the importance of the new Federal Laboratories for Human and Animal Health in Winnipeg. The facility is sure to contribute to national and international efforts in the scientific research and health education sectors. This major project required the participation and cooperation of at least five departments and agencies, as well as many consultants and sub-consultants who were involved in designing, planning and building the laboratory complex.

Considering the number of participants and the scope and complexity of the project, it is hardly surprising that there were problems and disagreements that resulted in delays and extra costs. However, the Committee believes that there would have been fewer cost overruns and delays if all the departments and agencies involved had been more rigorous in their practices related to financial management and control of the project.

What struck the Committee in particular was the reluctance of the Treasury Board Secretariat to apply its own directives and guidelines regarding monitoring, control and auditing. Given the scope of its mandate, it is essential that the Treasury Board Secretariat ensure rigorous control and closer monitoring so that capital projects stay within their approved budget.

The Committee now expects all the departments and agencies to do everything in their power to rectify the problems and deficiencies noted in the Auditor General's report. The measures taken as a result of the Auditor General's recommendations and those made by the Committee should ensure better management of major capital projects in the future.

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings (Meetings nos. 36 and 41)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 21 October 1998

Department of National Defence: Equipping and Modernizing the Canadian Forces, and Buying Major Capital Equipment

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

EIGHTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapters Three and Four of the April 1998 Report of the Auditor General of Canada (*Department of National Defence: Equipping and Modernizing the Canadian Forces*, and *Department of National Defence: Buying Major Capital Equipment*) and the Committee has agreed to report the following:

Introduction

The Department of National Defence (DND, the Department) spends almost \$1.4 billion annually to modernize and equip the Canadian Forces and to ensure that it is capable of fulfilling Canada's defence policy as set forth in the 1994 Defence White Paper. The White Paper calls for a modern, multi-purpose force. The Department's capital program is the largest in government; over the next five years, it plans to spend almost \$6.5 billion to buy new equipment.

In his Report of April 1998, however, the Auditor General of Canada, called into question the Department's ability to use the funds available to it to modernize its capital equipment in the most effective manner.

Due to the large sums of money involved, and the necessity that it be well spent to protect the safety of the men and women in the forces and to achieve Canada's defence policy, the Committee decided to examine Chapters Three (*Department of National Defence: Equipping and Modernizing the Canadian Forces*) and Four (*Department of National Defence: Buying Major Capital Equipment*) of the Auditor General's April 1998 Report. Accordingly, the Committee met with Mr. David Rattray, Assistant Auditor General, and Mr. Peter Kasurak, Principal of Audit Operations Branch, on 28 May to discuss the results of the audit reported in Chapter Four. Mr. Jim Judd, Deputy Minister, General Maurice Baril, Chief of Defence Staff, and Mr. Pierre Legueux, Assistant Deputy Minister, Materiel, represented the Department of National Defence. The Committee met again with the same witnesses on 2 June 1998 to review Chapter 4. Mr. Denis Desautels, the Auditor General of Canada, joined the other witnesses at that meeting.

Observations and Recommendations

A. Equipping and Modernizing the Canadian Forces

The Department of National Defence is faced with numerous challenges as it endeavours to modernize and equip Canada's armed forces. Reduced funding combined with the rapid technological change and high costs make the task difficult. In addition, the Auditor General reports that increasing personnel, operation and maintenance costs are further eroding the portion of the Department's budget that is available for capital equipment. (3.4, 3.60–.66)

These pressures emphasize the need for careful planning and priority setting to ensure that the funds available for capital equipment are spent effectively. The Auditor General found, however, that Department lacks an

adequate policy framework to guide equipment modernization. The results are manifested in equipment deficiencies and shortages uncovered by the audit which limit the capabilities available to implement defence policy. (3.23) The Auditor General warns, "if the status quo persists, the Department's available capital funding may not be sufficient to equip and modernize the force that National Defence is currently planning." (3.3)

In response to the observations made by the Auditor General, Mr. Jim Judd, DND's Deputy Minister, indicated that the Department is taking steps to address problems identified by the audit. He informed the Committee that these steps include the development and implementation of:

- a new financial system that will be in place in the year 2001;
- a set of conflict scenarios, slated to be in place during 1998, that will be used to guide the acquisition of equipment;
- a set of performance measurement indicators, due in 1999; and
- a new business planning process intended to match defence resources with defence policy objectives.

Mr. Judd also told the Committee that he wants to develop a "more encompassing priorities setting exercise that cut[s] across all the services, deal[s] with all the equipment issues, ... able to balance off all requirements and trade-offs within them." (1650) He envisaged this exercise taking place on an annual basis.

The Committee welcomes these commitments and notes the Department's willingness, as expressed throughout the meeting, to return within six months to discuss progress. The Committee also notes that witnesses from the Office of the Auditor General were generally satisfied with the Department's responses. The Committee anticipates that the Department will act expeditiously on its commitments and looks forward to reviewing the progress that has been made. The Committee therefore recommends:

That the Department of National Defence prepare a status report on its efforts to correct the shortcomings identified by the Auditor General. This report must include references to progress in developing and implementing a new financial system, conflict scenarios, performance measurement indicators, and an encompassing priorities setting exercise, showing how these measures contribute to an improved capital equipment program. This status report must also include an implementation timetable and be submitted no later than 31 March 1999.

Both the Auditor General and DND acknowledge that the Department will have to make some hard choices as it modernizes and equips Canadian forces in the years to come. This reality, combined with the size and importance of the expenditures involved, provides a compelling argument in favour of close parliamentary scrutiny of the Department's plans and performance. In order to facilitate scrutiny, Parliament must be given regular assessments of the status of the Canadian Forces. In addition, Parliament must also be kept aware of the Department's plans for capital acquisition and receive performance information that shows how well the Department is meeting its objectives. The Committee therefore recommends:

That beginning in fall 1999 the Department of National Defence include the following in its annual Performance Report:

- **A comprehensive defence review and assessment; and**
- **The Department's long-term capital acquisition plan and relevant indicators that show its performance in attaining defence capability goals.**

B. Buying Major Capital Equipment

In conjunction with his audit of DND's efforts to modernize and equip Canada's armed forces, the Auditor General looked at the Department's management of six major capital projects with a total value of \$3.3 billion.

Although the audit results indicated that all of the projects examined would likely meet their contract cost and performance objectives, the Auditor General expressed concerns about several of the Department's management practices surrounding the projects that he observed.

The audit found that professional judgement alone, rather than a systematic threat assessment and tactical analysis was often used in making spending decisions. Options analysis, which identifies different ways of meeting requirements along with the relative cost and effectiveness of each alternative, was often inadequate. Operations research, the application of scientific methods to the solution of military problems, could have played a more prominent role in shaping important capital acquisition decisions. Risk management, which helps to identify and minimize project costs, schedule slippage, and products or systems that do not meet performance goals, was either absent or inadequate. The Department could have made more effective use of testing and evaluation of equipment prior to purchase and during acquisition. Finally, the Department lacked an adequate framework for reporting project performance to senior managers.

The Department indicates that it has taken a number of corrective measures in response to these observations. Steps include plans to reform the capital acquisition process (in concert with Treasury Board Secretariat, Public Works and Government Services Canada, Industry Canada, and private-sector representatives). As part of this effort, the Department has issued a draft *Acquisitions Reform Guide* and has developed an initial draft acquisitions plan which it has provided to the Auditor General. (1630) Mr. Judd indicated that the goal is to have a new process within the next twelve months (1615) and Mr. Lagueux stated that completion date will likely be towards the end of 1999. (1630)

The Department has also acted to improve risk management of its major capital projects. Mr. Lagueux testified that in 1993, the Department established a standard for the preparation of the statement of work. He indicated that this would result in contractors having a formalized risk management plan and risk management program as part of all bid proposals. (1600) Mr. Lagueux also told the Committee that beginning in 1996, the Department has revamped the project management training that it provides its staff, adding a new course dealing specifically with project risk management. (1605) He also informed the Committee that the Department has done a complete review audit of its testing and evaluation process approximately one year ago. (1705)

The Committee welcomes the Department's efforts to improve management practices for its major capital projects. The Committee also notes the willingness expressed by Mr. Judd exchange ideas with the Office of the Auditor General on the Department's management of major capital projects and where improvements can be made. (1720) Nevertheless, the Committee believes that a number of additional measures must be taken in order to ensure that these efforts produce the desired results.

In particular, the Committee is concerned that the audit discovered "significant gaps in the analysis of requirements and options before purchase decisions were made," (4.41) and a "significant gap" in tactical analysis. (4.47). Insistence that these elements of major capital projects be completed before purchase decisions are taken would help ensure that the Department acquires the right equipment at the best price. The Committee acknowledges Mr. Judd's commitment to doing requirements and options analysis as a matter of principle (1710) and recommends:

That the Department of National Defence strengthen its requirements and options assessment process, and tactical threat analysis, making them necessary elements for all major capital acquisition decisions, and include prominent reference to them in the final version of its *Acquisition Reform Guide*.

The Committee is also concerned that adequate tests and evaluations be carried out prior to purchase and during acquisition to confirm that the right type of equipment is being purchased. As the Auditor General noted, tests and evaluations are particularly necessary in those instances in which the Department is purchasing commercial-off-the-shelf or military-off-the-shelf equipment and plans to use it in ways that have not been tried by commercial users or other military organizations. (1535) The Committee is in agreement and recommends:

That the Department of National Defence conduct operational testing, particularly of all commercial-off-the-shelf or military-off-the-shelf equipment when the Department plans to use it in ways that have not been tried by commercial users or other military organizations, before entering into full contracts with suppliers.

Lastly, the Committee notes the Auditor General's observation that there are "no established standards and predefined project performance indicators that can be used as a basis for monitoring and reporting" project status information. (4.131) The Committee is aware of the work being done by the Department with Public Works and Government Services Canada, Treasury Board Secretariat and Industry Canada to harmonize and implement various procurement reform initiatives across government. It believes that reforms are also necessary at the project management level within the Department. The Committee therefore recommends:

That the Department of National Defence develop and implement a framework for reporting project performance to senior managers of major capital projects. This framework must include standards and project performance indicators and should be in place by 31 March 1999.

Conclusion

In the Committee's view, it is vitally important that the Department of National Defence be able to achieve a balance between the equipment it needs and the resources available for that purpose. This can only be achieved through meticulous planning and careful management, especially in a resource-scarce environment. Furthermore, Canadians and their Parliament must be adequately informed of the results achieved by Department with funds that it has been given to modernize and equip Canada's armed forces. Parliament has a role to play in scrutinizing the decisions that are made and the outcomes that are produced. The Committee anticipates that its recommendations, together with those made by the Auditor General, will assist the Department in achieving those objectives.

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings (Meetings nos. 34, 35 and 41)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Tuesday, 1 December 1998

The Financial Information Strategy: A Key Ingredient in Getting Government Right

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

NINETEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 18 of the September 1998 Report of the Auditor General of Canada (*The Financial Information Strategy: A Key Ingredient in Getting Government Right*) and the Committee has agreed to report the following:

Introduction

For 35 years, there has been a common call for improvements in financial information to support government decision making. Two Royal Commissions (Glassco and Lambert) in 1962 and 1979, two reports from the Auditor General's Office (in 1976 and 1987) and the Independent Review Panel on the Modernization of Comptrollership in the Government of Canada (1997), all concluded that current governmental accounting practices could not adequately support managerial decisions. Especially lacking were comprehensive accounting systems that would relate operational data with financial data in order to determine the costs of governmental programs and activities.

All Commissions, Reports and Reviews recommended that the federal government change its accounting standards and practices towards a full accrual basis. Full accrual accounting would provide more consistent financial information, greater cost consciousness, better decisions making and better evaluation of performance, all leading to better accountability.

The Financial Information Strategy (FIS) was approved, initially, in 1989 but progress was slow until 1995. At that time, the Minister of Finance provided much needed encouragement for the project by announcing the government's intention to move to full accrual accounting. The government plans to have the FIS in place by 2001.

Because of the critical importance of having effective and efficient financial reporting systems in order to support governmental decisions and ensure better accountability to Parliament, the Committee decided to examine Chapter 18 of the Auditor General's September 1998 Report. Accordingly, on 29 October 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Ron Thompson (Assistant Auditor General) and Mr. Douglas Timmins (Assistant Auditor General). Representing the Treasury Board of Canada – Secretariat were Mr. J. Colin Potts (Deputy Comptroller General, Comptrollership Branch) and Mr. Jim Libbey (Director, Financial Management Standards, Comptrollership Branch).

Observations and Recommendations

In his opening statement, the Auditor General of Canada, Mr. Denis Desautels, (1536) told the Committee that the Financial Information Strategy (FIS) consisted of three components: the introduction of full accrual or businesslike accounting; the implementation of new financial systems throughout the government; and the integration of improved financial information into day-to-day decision making by departmental managers.

The Auditor General indicated that the first two components were progressing well but expressed concern about the third component – the integration of financial information into day-to-day decision making. The Auditor General emphasized that the third component is the most critical and must be implemented on a timely basis for FIS to be considered a success. However, the Auditor General continued, incentives for more timely implementation of the third component have yet to emerge (1540).

Successful and complete implementation of the third component requires deputy minister participation or “buy-in” to FIS. However, the government’s own FIS Training Framework indicated that departmental commitment to FIS is not complete.

The Auditor General stated that the central agencies have an important role to play in securing commitment to FIS. The FIS will impact every aspect of operations in the Government of Canada and its successful implementation will depend on the active co-operation and co-ordination of all departments and agencies. The Auditor General emphasized that strong leadership by the Treasury Board Secretariat, as overall project manager, will continue to be crucial. The Auditor General noted that the Secretariat intends to require departments to prepare the financial information in their Reports on Plans and Priorities and their Performance Reports on a full accrual basis. The Auditor General went on further by stating that the Privy Council Office also had a role to play in encouraging departmental commitment to FIS, as part of its responsibilities for the strategic management of senior personnel.

The Auditor General suggested that Parliament could provide further impetus to the implementation of FIS by changing the basis on which appropriations are prepared. Four out of five accountability documents – the Budget, the Public Accounts, departmental Reports on Plans and Priorities and departmental Performance Reports – are planned to be prepared under full accrual basis. However for the fifth accountability document – the Main Estimates and the associated Appropriations – no plans have been announced to indicate that this important document will move towards a full accrual basis.

Given that departmental management places high priority on the demands of Parliament, the basis on which Parliament appropriates resources will heavily influence the way departmental management plans and manages its operations. The Auditor General believes that moving towards an accrual based appropriation process, where departmental operations would be charged according to the costs of resources consumed instead of resources acquired, would provide additional incentive to deputy minister “buy-in”, change departmental culture and strengthen the prospects of full implementation of the FIS. As a result, the Auditor General would like to see the Treasury Board Secretariat request Parliament to grant appropriations on a full accrual basis in the not-too-distant future (1545).

In his statement to the Committee, the Deputy Comptroller General, Mr. J. Colin Potts, agreed with the Auditor General’s observations that the integration of the FIS into departmental management is critical as well as the necessity to obtain departmental buy-in at senior levels. In light of this, Mr. Potts reported to the Committee that departments across government are implementing new financial systems, and the central systems of government are being upgraded accordingly. The Treasury Board Secretariat official stated the first Departments are scheduled to be converted to the new central systems by April 1, 1999.

Mr. Potts also mentioned other current initiatives such as the 16 training modules have already been defined for the FIS, of which the first four are to be piloted in the fall of 1998. Mr. Potts agrees that integrating FIS to departmental management is critical and that the training courses will assist management. As for the department “buy-in” at the senior level, Mr. Potts believes that issue is being addressed, at least partially, through the Comptrollership Modernization Task Force consisting mainly of deputy ministers, the Comptrollership Council consisting of assistant deputy ministers, and other various communications vehicles (1550).

Treasury Board Secretariat is currently examining options as to how Parliament can provide full accrual based appropriations to departments and programs. Mr. Potts indicated to the Committee that Treas-

sury Board Secretariat is consulting with various stakeholders as to find the best approach to introduce full accrual based appropriations.

The Committee pressed the witnesses as to how it could provide assistance and support to ensure the successful implementation of the FIS. Mr. Potts answered that Parliament and, particularly, the Public Accounts Committee, could support the FIS by “creating the demand for results-based information” (1555). The Committee continued by asking the witness whether legislative amendments would be required to bring about the desired changes in the Appropriations process. Mr. Potts indicated that new legislation may be required but Treasury Board Secretariat is also exploring other possible procedural options to move the appropriations process to a full accrual basis.

Considering the above prompts, the Committee to recommend the following:

That Treasury Board Secretariat complete as quickly as possible its consultations with its stakeholders in order to determine the best possible options to move the appropriation (supply) process to full accrual basis; and

That Treasury Board Secretariat report to Parliament, on a regular basis, the progress of its consultations and, once an option is chosen, report to Parliament on the progress of the move towards a full accrual based appropriations (supply) process.

The Committee asked the witnesses about potential impediments to the full implementation of the FIS. The Auditor General stated that in order to be successful, the FIS requires that all departments and agencies to be fully capable to update and upgrade their systems within the stated deadlines. Failure by a major department to upgrade its systems in time will likely have serious repercussions on the rest of the accounts of Canada (1555). The Committee thus recommends:

That Treasury Board Secretariat monitor the progress of the Financial Information Strategy (FIS) across all Departments and Agencies, regularly report to Parliament of the progress of the FIS, and immediately inform Parliament of any major impediment preventing full implementation of the FIS by its target date of 2001.

The Committee also enquired about the total costs related to the implementation of the FIS. The Auditor General stated that there were presently no reliable estimates of the total implementation costs of the FIS. The amount would likely be substantial since the project started in 1989 and is scheduled to be completed by 2001 (1605). The Auditor General, without stating a total dollar amount, told the Committee that to arrive at an estimate of the total investment required to implement the FIS, one had to take into account the total amount spent by each individual departments and agencies in updating their current systems. One also must add the costs in updating the central systems.

The Deputy Comptroller General, Mr. Colin Potts, agreed with the Auditor General that it is difficult to accurately estimate the implementation costs of FIS. One has to take into account system hardware and software costs, training, staffing and other costs. The tallying of the cost is difficult at best under current systems and practices. However, the Deputy Comptroller General offered a tentative estimate of the overall implementation cost of between \$400 and \$500 million over the life of the initiative (1615).

The Committee therefore recommends:

That Treasury Board Secretariat provide Parliament, on a regular basis, better estimates of the total implementation costs, as systems and accounting practices are updated across government.

Conclusion

Even as the Financial Information Strategy (FIS) is progressing, the audit identified risks that might prevent or at least delay the complete implementation towards full accrual accounting. The third component of the FIS, the integration of financial information to day-to-day decision making, will require the full co-operation from departments and agencies in order to be fulfilled. The witnesses told the Committee that the way of securing this co-operation from departments and agencies is for Parliament to change the appropriations process in such a way that departmental planning, managing and reporting will primarily be concerned on the use of resource to achieve results. The Committee feels that this option should be pursued with all diligence and speed given the potential benefits and improvements to government decision making and accountability to Parliament.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 43 and 47)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Thursday, 4 February 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTIETH REPORT

The Standing Committee on Public Accounts has considered Chapter 16 of the September 1998 Report of the Auditor General of Canada (*The Management of the Social Insurance Number*) and the Committee has agreed to report the following:

Introduction

Introduced in 1964, the Social Insurance Number or SIN was originally intended as a file number for Unemployment Insurance (UI), Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) clients. However, over the years, the SIN has become the gateway to a multitude of federal and provincial programs. The SIN is used to identify and gather information on taxpayers and social program recipients, to verify entitlement to certain types of pensions and benefits, and to match and exchange data among programs.

The roles and responsibilities with regard to the SIN are shared among various federal departments and agencies. Human Resources Development Canada issues SINs, maintains the Social Insurance Register (SIR) and investigates suspected abuse. The Treasury Board is responsible for the policy and guidelines that govern the collection and use of data related to the SIN. The Office of the Privacy Commissioner investigates complaints about the SIN. The Department of Justice responds to general enquiries from the public on the private sector's use of the SIN.

Because of its uniqueness and universality, the SIN lends itself to data matching, comparison and exchange between and among jurisdictions in such a way that it has become in practice a de facto universal identifier. Today, over 20 federal statutes, regulations and programs authorize the use of the SIN. Its use has also expanded into provincial social programs and into the private sector.

The unintended expansion of uses of the SIN throughout the public and private sectors across Canada has raised concerns regarding its integrity, security and overall management. Given the importance of the Social Insurance Number to the social and economic welfare of Canadians, the Committee decided to examine Chapter 16 of the Auditor General's September 1998 Report. Accordingly, on 19 November 1998 the Committee met with Mr. L. Denis Desautels (Auditor General of Canada) and Mr. David Rattray (Assistant Auditor General). Representing Revenue Canada were Mr. David W. Miller (Assistant Deputy Minister, Assessment and Collections Branch) and Ms. Kathy Turner (Director General, Benefits Programs Directorate, Assessment and Collections Branch). Mr. Hy Braiter (Senior Assistant Deputy Minister, Service Delivery Network), Mr. Bob Nichols (Director, Insurance Program Services) and Mr. Jacques Bourdages (Associate Director, National Services, Bathurst) represented the Department of Human Resources Development Canada.

Observations and Recommendations

In his opening statements, the Auditor General informed the Committee about certain shortcomings in the management of the Social Insurance Number. These weaknesses were found to be detrimental to the proper management of social programs. These weaknesses could lead to errors, abuse and fraud and, collectively, the

impact could be sizeable. The Auditor General pressed for the need for corrective action in order to protect public funds and taxpayers.

The Auditor General also stated the Department of Human Resources Development accepted the audit's recommendations and that the Department has already taken actions to improve the integrity and security of the Social Insurance Registry (SIR) and is co-operating with the provinces to improve the administration of the SIN (1535).

But many of the questions raised far exceed management and administration issues of the SIN. The Auditor General stated that now was the time for the federal government to review the roles, objectives and uses of the Social Insurance Number. The government should determine what it wants to do with the Social Insurance Number, and at the same time study other possible options (1540).

In this regard, the witness for HRDC, Mr. Hy Braiter, agreed with the Auditor General's position that discussions and consultations are required to determine whether Canada needs a national identifier system instead of the current SIN, a system initially intended as a personal account number (1545). Mr. Braiter informed the Committee that HRDC has already begun discussions on this matter with lead departments and agencies such as the Treasury Board, the Department of Justice, Revenue Canada and the Office of the Privacy Commissioner, but, ultimately, the final direction and decision must come from Parliament (1550).

Certain Committee Members inquired that, since the SIN has become a de facto national identity card, maybe it was time to update the administration and management of the SIN card system to match its current use. The Auditor General responded that a case could be made to examine the possibility of replacing or converting the SIN into a single national identifier. That many countries have considered the possibility of introducing a single identifier, but, to date, none has yet fully implemented such an identification system. The Auditor General indicated that the main difficulty associated with a single identifier system was the protection of private information (1620).

Other Committee Members preferred the option of restricting the use of the SIN because of privacy concerns related to the use of a single national identifier. A single national identifier system would require the accumulation of substantial amounts of private information about financial, health and other personal data and the risk of unauthorized access would become a real possibility with very serious repercussions (1635). The Committee was even invited to support a Private Member's bill to ban unauthorized use of the Social Insurance Number in the private sector (1605).

The Committee further inquired whether it was possible to design a national identifier system that would have all the administrative and managerial advantages of a single identifier and yet be able to address the privacy issues. The Auditor General stated that technological solutions may be available that would permit a system similar to something like a national identifier but be capable of segregating data to protect information from unauthorized intrusion (1645).

The witness from Human Resources Development, Mr. Hy Braiter, believed that such a system was technically feasible. Smart card technology together with biometric identification could combine both the administrative efficiencies of a single identifier and, at the same time, provide relative protection of private information, but the witness hastened to add that no system was completely foolproof and anti-intrusion features can be rendered ineffective. Mr. Braiter concluded his remarks by stating that this is more a policy issue than a technological issue. Political direction from the Government of Canada is required to determine whether we move towards a single national identifier or return the present SIN system to one nearer its original design and intent (1650).

This leads the Committee to recommend the following:

That Human Resources Development, together with Treasury Board, the Department of Justice, Revenue Canada and the Office of the Privacy Commissioner, complete their consultations and

prepare a set of possible options to improve or replace the current Social Insurance Number and present their recommendations to the Parliament of Canada by 15 June 1999.

The Committee also expressed concerns about weaknesses found in the administrative processes and data integrity of the SIN. The audit uncovered examples of data reliability problems in the Social Insurance Register (SIR), of minimal efforts dedicated to investigation of SIN fraud, of “temporary” SINs without expiry dates, and the unregulated use of SIN in the private sector. The witness for Human Resources Development, Mr. Hy Braiter, acknowledged the seriousness of the issues raised in the audit and informed the Committee that HRDC has already taken various corrective actions to deal with the outstanding issues identified in the audit. Many of the actions taken are in the form of increased data matching and sharing between departments and jurisdictions to better ensure data integrity and security of the SIR.

Mr. Braiter also informed the Committee that the Department has established five working groups to deal with the Auditor General’s recommendations (1550). The first working group is studying the accuracy and completeness of the personal information contained on the SIR. The second group is looking at proof of identity requirements for SIN applications. The third group is looking into ways to prevent SIN offences and abuses. The fourth group is investigating ways to improve SIN investigations and, finally, the fifth group is looking at security features on the SIN card itself (1555).

The Committee was interested with the activities of the five working groups and requested HRDC to provide the action plans and timetables for each working group. Mr. Braiter agreed to the request (1700). Thus the Committee recommends the following:

That Human Resources Development provide to Parliament by 15 June 1999 the action plans and the specific timetables from each of the five working groups set up to respond to the Auditor General’s recommendations on the management of the Social Insurance Number.

That Human Resources Development report annually through the Performance Reports to Parliament on the progress being made by each working group compared against their timetables and inform Parliament of any delay or impediment to the full implementation of the corrective measures.

An issue of particular concern to the Committee was the observations in the audit of the minimal effort dedicated to investigations of SIN fraud and that the existing performance indicators discouraged SIN investigations. Mr. Braiter told the Committee that compared to the return on Employment Insurance or CPP investigations, SIN investigations offered a much lower return and thus Department officials had less incentive to investigate SIN fraud (1655). Also, the court system is reluctant to take on cases of SIN fraud because the penalties and sanctions are so low that it isn’t worth the time and effort to prosecute the perpetrators of SIN fraud. Mr. Braiter told the Committee that HRDC is considering applying administrative penalties similar to those applied in cases of Employment Insurance abuse (1625). Considering the above, the Committee recommends the following:

That Human Resources Development design and implement a performance indicator for SIN investigations that takes into account not only the savings to the Employment Insurance program but also to other federal, provincial, territorial and municipal programs.

That Human Resources Development replace the existing system of sanctions for a system of sanctions, administrative penalties or possible criminal charges corresponding to the seriousness of the offences, related to the fraudulent use of the SIN.

That Human Resources Development monitor the progress of the proposed initiatives and inform Parliament through the Performance Reports of any delay or impediment to the implementation of these initiatives.

The Committee observed that there was no mention of the Social Insurance Number program in the Department's Annual Performance Report. Mr. Braiter agreed that this was an issue that needs to be addressed and assured the Committee that the inclusion of the SIN program in the accountability documents is a departmental priority. This prompts the Committee to recommend:

That Human Resources Development incorporate in its Annual Performance Report to Parliament a regular report on the management of the Social Insurance Number program.

Conclusion

A well-managed Social Insurance Number program (SIN) is essential to the economic and social welfare of all Canadians. While the audit uncovered many shortcomings in the administration of the SIN program, these issues are really subordinate to the resolution of the central question concerning the goals and objectives of the Social Insurance Number. From a simple file account number to a *de facto* national personal identifier, the actual use of the SIN has far exceeded its original purpose. Resolution of the SIN mandate is essentially a political issue and will require a decision from the Parliament of Canada. Once a decision is rendered, the administrative issues identified by the audit can then be satisfactorily resolved.

In his closing comments to the Committee, the Auditor General of Canada remarked that the corrective initiatives proposed by the representatives of Human Resources Development Canada seem to cover all the administrative issues raised in the audit (1710). He suggested that HRDC submit to the Committee the action plan timetables so that they can be used as benchmarks in order to monitor the progress of the action plans. The Committee duly noted this and also noted the seriousness manifested by all departments present to resolve all the outstanding issues relating to the management of the SIN. The Committee intends to closely monitor the future developments regarding the Social Insurance Number program.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 45 and 50)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Tuesday, 9 February 1999

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-FIRST REPORT

The Standing Committee on Public Accounts has considered Chapter 10 of the September 1998 Report of the Auditor General of Canada (*Canadian Human Rights Commission, Canadian Human Rights Tribunal Panel*) and the Committee has agreed to report the following:

Introduction

Canadians pride themselves on having built a society that strives toward tolerance, and respect for the individual human rights of all citizens. To promote and protect these rights, Parliament adopted the *Canadian Human Rights Act* (the Act) in 1977. The Act applies to federal government departments and agencies, Crown corporations, and federally regulated businesses and industries.

The Canadian Human Rights Commission (the Commission) was established by Parliament to administer the Act. Included in its role was a mandate to foster public understanding of the Act and recognition of its principles. The Commission was also given the task of investigating complaints of discrimination lodged under the Act.

If, following an investigation of a complaint, the Commission determines that an inquiry is warranted, it refers the matter to the Canadian Human Rights Tribunal (the Tribunal), a quasi-judicial body. The Tribunal then holds hearings to decide whether a discriminatory practice, as defined under the Act, has occurred. Like the Commission, the Tribunal's mandate is established by the Act.

Parliament originally created the Commission and the Tribunal as an alternative to the more formal legal processes of the Federal Court and as a means to achieve prompt, impartial, and expert resolution of human rights complaints. However, the approach that has evolved has become cumbersome, time-consuming and expensive.

During fiscal year 1997–98, the Commission spent approximately \$15 million. For fiscal year 1998–99, it plans to spend about \$14.8 million. This amount includes about \$800,000 that will be used by the Commission to conduct employment equity audits as required under recent amendments to the *Employment Equity Act*. The Tribunal's budget for 1997–98 was about \$1.9 million; in 1998–99 it is expected to be about \$2.2 million. These expenditures by the Commission and the Tribunal do not include costs incurred by complainants or by respondents who are often federal government departments or agencies.

The two bodies mandated by Parliament to administer and enforce the *Canadian Human Right Act* play crucial roles in safeguarding the rights of individual Canadians. As a consequence of this and the costs incurred, the Committee decided to hold a hearing on the results of an audit performed by the Auditor General Canada of the Commission and Tribunal. Accordingly, the Committee met on 27 October 1998 with Mr. David Rattray, Assistant Deputy Auditor General and Mr. Alan Gilmore, Principal, Audit Operations Branch, from the Office of the Auditor General of Canada. Mrs. Michelle Falardeau-Ramsay, Chief Commissioner, and Mr. John Hucker, Secretary General, represented the Canadian Human Rights Commission. Ms. Anne Mactavish, President, and Mr. Michael Glynn, Register, represented the Canadian Human Rights Tribunal.

Observations and Recommendations

The audit's most striking finding was that the Commission takes an inordinately long time to process complaints. For example, since January 1996, the Commission took almost two years on average to reach about 1,170 final decisions. In about 16 percent of cases, it took three or more years. (10.41) This contrasts with the Commission's own standard of nine months to investigate a case and about one year to reach a final decision.

Lengthy periods to investigate complaints and to reach final decisions have resulted in a considerable backlog of cases. According to the Commission's own definition, a complaint is in backlog if it is still under investigation nine months after it has been filed. Using this benchmark, the audit discovered that, in 1997, 48% of the Commission's 900 open cases were in its backlog. (10.49)

The long length of time taken by the Commission to process complaints and the resulting backlogs are not new phenomena; the Auditor General made similar observations in Chapter 11 of his Report to the House of Commons in 1985. Subsequent efforts to address these problems have not met expectations.

The Commission did not refute the findings of the latest audit. The Chief Commissioner instead stressed the growing complexity of the environment in which the Commission operates and the steps that it will take to produce swifter resolution of complaints. These measures include putting together a task group to focus on clearing up delayed complaints, providing more specialized training for staff, and instituting a human resource plan intended to help the Commission retain trained and experienced investigators. The Chief Commissioner told the Committee that she was confident that these efforts would place the Commission on a firmer footing in two years. (1550)

Although the Committee recognizes that the Commission is attempting to address delays and backlogs both now and in the future, it has several concerns regarding the Commission's plans. The first involves the projected cost of these efforts. The second involves previous attempts that have failed.

The Chief Commissioner told the Committee that a "one-shot deal of money would be necessary" to clear up the current backlog over two years (1620) and that the Commission "will be requesting additional funds to supplement the action" being taken internally. (1550) In his Report, the Auditor General indicated that this request might amount to \$1 million. (10.53) The Assistant Deputy Auditor General, however, advised the Committee that the problems revealed by the audit "cannot be simply solved by providing more resources."(1545)

The Committee notes that the Commission has received additional funding in the past to clear up its backlogs. In 1989–90, for example, it was given a permanent annual funding increase of approximately \$411,000 for the purpose of eliminating its backlog over a five-year period. Between 1992–93 and 1997–98, the Commission spent almost \$1 million to hire contractors to conduct investigations in an effort to reduce its backlog. Clearly, if the solution were simply to spend more money, time standards for investigations and complaint resolution would have been met by now, and backlogs either eliminated or significantly reduced.

In its most recent Performance Report (for the period ended 31 March 1997), the Commission informed Parliament that it is giving priority to eliminating its backlog and improving the complaint process. To this end, it had put in place a review and oversight process providing for management direction at critical points and had begun to develop a mediation project intended to resolve a significant number of complaints early in the process. In a footnote, the Commission added that since the end of fiscal year 1997–98, it had taken other steps such as reallocating resources, on a temporary basis, to reduce the backlog and reviewing its compliance standards and procedures. It goes on to indicate that it will report on these measures in its next Performance Report.

In light of the above observations, the Committee concludes that the expenditure of additional funds alone will not contribute to the long-term solution of the problem and recommends instead:

That the Canadian Human Rights Commission assign priority to investigating and resolving complaints lodged under the *Canadian Human Rights Act* by continuing to explore opportunities offered by the reallocation of resources from within its existing budget.

In addition, the Committee recommends:

That the Canadian Human Rights Commission delay requesting additional funding until such time as it has thoroughly assessed the measures it has taken to eliminate its backlog and improve the processing of complaints and can report the results to Parliament.

Furthermore, the Committee recommends:

That should the Canadian Human Rights Commission come forward with a submission for additional funding for this purpose, Treasury Board Secretariat take into account the concerns expressed by this Committee and the Auditor General of Canada. In particular, Treasury Board Secretariat must seek firm assurances that any additional funding, should it be granted, will be directed exclusively toward the purposes outlined in the submission.

In his Report, the Auditor General mentions a specific means that could be used by the Commission to expedite processing of complaints. In paragraph 10.83, he asserts that the Commission's conciliation efforts would be improved by using mediation upon the receipt of a complaint. The Ontario Human Rights Commission recently initiated a voluntary mediation program to resolve cases early in the investigation process. The Auditor General suggests that if the Canadian Human Rights Commission were to establish a similar mediation program, it "could result in complaints being resolved sooner and with less cost." (10.84)

As previously indicated, the Commission has developed a mediation project for implementation in 1998–99. The Commission asserts that this mediation project "will resolve a significant number of complaints early in the process, thus reducing the need for investigation, conciliation and litigation."

The Committee believes that this measure has the potential to reduce the number of complaints requiring investigation to a more manageable level, thus reducing the time involved, as well as the backlog and costs. The Committee therefore recommends:

That the Canadian Human Rights Commission proceed with the implementation of its early mediation program during the current fiscal year (1998–99), and

That the Canadian Human Rights Commission develop and make public specific numerical targets for the number of cases that will be dealt with through early mediation and regularly report progress against these targets in its Performance Reports beginning with the period ending 31 March 1999.

The Committee is concerned about the absence of specific detail with regard to the Commission's planned response to the Auditor General's recommendations. At one point in her testimony, Mrs. Falardeau-Ramsay stated that the Commission was in the process of setting up an action plan which would be provided to the Committee and the Auditor General. (1620) The Committee wishes to review this action plan and therefore recommends:

That the Canadian Human Rights Commission submit its action plan for reducing delays in its complaints investigation and resolution processes to the Standing Committee on Public Accounts no later than 30 April 1999. This plan must include target implementation dates and anticipated outcomes, such as specific targets for reducing delays and the backlog, for all of its components.

The quality of the investigations conducted by the Commission represents another area of concern. While the audit did not comment on the quality of the outcomes produced by investigations, it did reveal that two of the documents intended to contain information for investigations — the Complaint Analysis and Assignment Form, and the Investigation Plan — were often not completed. (10.70) This prompted the Auditor General to report that he was "concerned that the Commission is not consistently adhering to some of its key investigation standards that are designed to ensure the quality of investigations." (10.74)

In their testimony, Commission witnesses agreed that investigation plans were not completed in every case and that the Commission had not met its own standards in that regard. However, rather than adhering to these standards, the Commission indicates that they will be reviewed instead. In its response to the audit that appears in the Auditor General's Report, the Commission goes further, indicating that its standards were put in place when workloads were less demanding and that "their contribution to the investigation process may need to be reassessed."

The Committee agrees with the Auditor General that the existence of, and adherence to, clear investigation standards is required to ensure the quality of investigations. The Committee also agrees with Mr. Alan Gilmore who testified that the Office of the Auditor General believes that a commission that is investigating human rights "needs to have the information it says it needs to have, otherwise it is going to run into difficulty." (1710) There are several things that could be done to reduce the time it takes to complete investigations; eliminating or ignoring investigation standards must not be among them. The Committee therefore recommends:

That the Canadian Human Rights Commission retain its key investigation standards, clarifying them where necessary, and ensure that they are adhered to on a consistent basis for all investigations.

Furthermore, the Committee recommends:

That the Canadian Human Rights Commission conduct regular reviews of its investigations that include a review of adherence to standards and report the results in its annual Performance Reports.

In making the above observations and recommendations, the Committee is conscious that they are directed toward finding timely solutions to some of the problems identified by the audit. This is appropriate, given that the Committee's first concern is for the complainants and respondents who are currently awaiting resolution of human rights complaints. Their needs must be put first and taken care of now.

However, it is apparent to the Committee that the problems revealed by the audit are the result of much deeper systemic difficulties that minor administrative adjustments cannot address. If a lasting resolution is to be found, appropriate and timely legislative change based on a thorough review by Parliament must occur.

The Committee has observed that in his Report, the Auditor General made several references to issues that might appropriately be dealt with within the context of a broad review of the Act. These include:

- the absence of legislative safeguards to ensure the independence of the Commission and the Tribunal from government (10.26);
- the possibility of allowing those parties with sufficient resources and expertise to take their cases directly to either the Tribunal or the Federal Court of Canada, thus easing the caseload and expediting processing (10.45);
- the Commission's lack of legal authority to enforce deadlines (10.44), an obstacle also mentioned by the Chief Commissioner in her testimony (1635);
- the duality of the Commission's roles which, on one hand, require it to promote and advocate human rights, and to investigate complaints impartially, on the other (10.57); and
- the Commission's lack of clear authority to enter into contribution agreements. (10.104)

These issues, as well as several recommendations in paragraph 10.123 of the Auditor General's Report would require legislative change and should thus be addressed by a comprehensive review.

The Committee notes that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken, and that the Canadian Human Rights Commission, the Canadian Human Rights Tribunal, and the Auditor General of Canada are unanimous in their support for this proposal. Furthermore, Ms. Patricia Lindsey of the Department of Justice informed the Committee that the Department would soon be forwarding recommendations to the Minister of Justice on the best process for reviewing the Act.

Accordingly, the Committee joins with its witnesses in finding that the arguments in favour of a review are compelling and therefore recommends:

That by 31 March 1999 the appropriate Standing Committee of the House of Commons be instructed to conduct a thorough review of the *Canadian Human Rights Act*, and the Canadian Human Rights Commission and the Canadian Human Rights Tribunal, taking into account the concerns and recommendations of the Auditor General of Canada as expressed in Chapter 10 of his September 1998 Report to the House of Commons.

In closing, a number of differences were observed in the way that information was reported in the Commission's Performance Report for the period ending 31 March 1997, and the way similar information was reported in the audit findings. In order to fulfil its responsibilities to Canadians, Parliament must receive performance information that is direct and comprehensive. The Committee therefore welcomes the commitment by the Commission to improve its Performance Reports by reporting on the challenges it faces as well as its achievements.

Conclusion

On 1 October 1998, following the release of his September 1998 Report, the Auditor General presented his priorities to the Committee. When he spoke of the Canadian Human Rights Commission and the Canadian Human Rights Tribunal, he drew the Committee's attention to the fact that the "impact of [delays] on thousands of Canadians who seek redress for alleged causes of discrimination can be devastating." (1535) The Auditor General has pointed out that while Parliament established the Commission and the Tribunal to resolve human rights complaints quickly, impartially and expertly, the approach that has evolved has become "cumbersome, time-consuming and expensive." (10.1)

Timely action must be taken to speed up the investigations process and reduce the backlog of cases. At the same time, the philosophical foundations and the legislative and policy framework of the *Canadian Human Rights Act*, and the Canadian Human Rights Commission and the Canadian Human Rights Tribunal must be reviewed. Just over twenty years have elapsed since passage of the Act and establishment of the Commission and Tribunal. During that time, the human rights environment has evolved dramatically. It is time that the laws and administrative apparatus that support the protection and promotion of these rights be reviewed and, if necessary, renewed. This will ensure that Canada will have the most effective mechanisms for addressing human rights issues into the next century.

The Committee is confident that conscientious effort on the part of all concerned will result in an approach to the protection of human rights that will meet the demands of all Canadians.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (*Meetings Nos. 42, 50 and 51*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 10 March 1999

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-SECOND REPORT

The Standing Committee on Public Accounts has considered Chapter 14 of the September 1998 Report of the Auditor General of Canada (*Indian and Northern Affairs Canada ? Comprehensive Land Claims*) and the Committee has agreed to report the following:

Introduction

Comprehensive land claims are claims relating to ongoing Aboriginal title to land and rights that have not been dealt with by treaties or law. Settlement of these claims result in modern treaties.

Between 1975 and July 1997, twelve comprehensive land claims settlements were signed. These settlements involved approximately 48,000 Aboriginal people, full ownership of over a half-million square kilometres of land, and a financial package totalling \$1.8 billion, as well as other considerations. In 1997–98, it cost the federal government \$279 million to negotiate and implement comprehensive land claims settlements. For 1998–99, it is estimated that these costs will amount to \$262 million. At present, there are over 200 First Nations that have actual or potential land claims and treaties under discussion or to be addressed.

In his September 1998 Report, the Auditor General of Canada raised questions about the comprehensive land claims process. These questions related to the way in which the process is managed, settlements implemented, and the results measured and reported by Indian and Northern Affairs Canada, the federal department that bears responsibility in this area.

Given that the comprehensive land claims process is central to accommodating and achieving important aspirations of Aboriginal and non-Aboriginal Canadians alike, and that the costs to taxpayers and the Government of Canada is, and continues to be, substantial, the Committee decided to examine the audit results. Consequently, the Committee met on 24 November 1998 with Mr. Denis Desautels, the Auditor General of Canada, and Mr. Grant Wilson and Mr. Ted Bonder of the Office of the Auditor General to discuss the findings of their audit. Mr. Scott Serson, Deputy Minister, accompanied by Mr. Greg Gauld and Mr. Terry Henderson represented Indian and Northern Affairs Canada (INAC, or the Department).

Observations and Recommendations

In his Report and testimony before the Committee, the Auditor General acknowledged that the process of negotiating and implementing comprehensive land claims settlements is not a simple one. Nevertheless, his audit revealed shortcomings in three major aspects of the process ? achievements and results, negotiation, and implementation ? and made several recommendations designed to produce a better process and outcomes.

In its initial response (included in the Report), the Department was cautious and made no commitment to implement the Auditor General's recommendations. However, when departmental officials met with the House of Commons Standing Committee on Aboriginal Affairs on 3 November 1998, they indicated agreement with many of the audit observations and stated that the Department was preparing an action plan that would allow for consultation with its key partners to address the Report's recommendations.

The Department made a similar commitment when it appeared before this Committee, adding that it would work closely with the Office of the Auditor General in the development of the plan. In response to questioning, Deputy Minister Scott Serson testified that the target date for a draft of the action plan was “some time early in the new year, February or March” and that he was willing to provide a copy to the Committee. (1550)

The Committee wishes to encourage the Department’s decision to adopt a constructive approach to resolving problems brought to light by the audit. It therefore recommends:

That Indian and Northern Affairs Canada complete a draft action plan for addressing each of the findings and recommendations made by the Auditor General of Canada in Chapter 14 of his Report of December 1998 no later than 31 March 1999. This action plan must be provided to the Committee immediately following its completion.

Examination of the audit results and discussion with witnesses highlighted several issues that the Committee would like the Department to pay particular attention to as it drafts its action plan. These issues involve: measuring and reporting economic benefits generated by settlements; placing a value, during negotiations, on assets subject to transfer; keeping Parliament informed; and the involvement of non-parties to settlements.

The Department asserts that the promotion of economic development in areas affected by settlements is among the objectives of its current land claims policy (published in 1986). For example, in its *Report on Plans and Priorities* for 1998–99, the Department informs Parliament that negotiated settlements of land claims “resolve outstanding grievances, establish certainty to land title and access to lands and resources, create a climate that promotes economic development, and avoid time-consuming litigation.”¹

These same objectives are repeated in the Department’s *Performance Report* for the period ending 31 March 1998. But when the Department discusses its performance in the area of land claims settlements, it lists outputs — agreements signed and implemented — alone. Achievements related to tangible outcomes — in this case those related to creation of a climate that promotes economic development — receive no mention. As a consequence, Parliament and Canadians are unable to fully assess the benefits achieved as a result of the Department’s expenditures on this activity.

The absence of meaningful information on the outcomes of agreements is disappointing but not without explanation. The audit found that the Department had not carried out studies on the economic benefits of land claims and concluded that Indian and Northern Affairs Canada “has not done enough to demonstrate the deemed benefits relating to the economic impact of negotiated settlements.” (14.43)

In his opening statement, Deputy Minister Scott Serson went only so far as to indicate that a study of the impacts of treaties, restricted to those signed in the 1970s and 1980s, would be “a major undertaking” but one that “must be considered.” (1545) No commitment to conduct such studies for all current and future treaties and to report the results to Parliament was offered. In response to questioning from the Committee, Mr. Serson also indicated that the Department really had not given a great deal of thought as to what sort of mechanism could be used to report such information to Parliament. (1605)

The Committee believes that the Department must conduct studies of the economic benefits resulting from all comprehensive land claims settlements in order to determine the extent to which its policy objectives are being achieved. The resulting information must, in turn, be reported to Parliament. The Committee therefore recommends:

That Indian and Northern Affairs Canada establish indicators and a timetable for measuring and reporting the economic benefits produced as a direct result of all current comprehensive land claims settlements and provide them to the Committee no later than 31 May 1999;

¹ Indian and Northern Affairs Canada, *Report on Plans and Priorities, 1998–99*, Ottawa, 1998, p. 28.

That Indian and Northern Affairs Canada include specific provisions for timely and periodic impact evaluations in all future comprehensive land claims settlements; and

That Indian and Northern Affairs Canada provide information on the outcomes achieved as a result of comprehensive land claims settlements in its annual Performance Reports beginning with the Report for the period ending 31 March 1999. These outcomes must include specific reference to direct economic benefits generated by the settlements.

Typically, the transfer of ownership of and rights to large tracts of land and resources, previously held by the Crown, and the payment of substantial amounts of money to Aboriginal communities are involved in claims settlements. It is essential that the Department, as part of the negotiation process, establish the value of the assets subject to transfer as accurately as possible. In particular, the Department should possess adequate information on the existence and potential value of subsurface resources.

The Auditor General reports, however, that the Department “has not demonstrated that it has always exercised adequate rigour” when determining the nature and amount of assets that may ultimately be included in final settlements. (14.51) Concerns have been raised within the Department itself regarding the reliability of studies of claimed land, the lack of assessment of the impact of transferring such land, and that the determination of resource royalty sharing was done without the use of detailed data on resource potential. (14.52)

In his opening statement, Mr. Serson also touched on the issue of valuation. He told the Committee that although it is difficult to put a price on land and natural resources in the North, the Department intends to continue efforts to find more precise ways to measure the value of treaty components during the negotiation process. As an example, he cited the Department’s practice of commissioning valuation studies when resource potential in a claimed area appears to be significant. (14.45) The Committee welcomes the Department’s intentions and recommends:

That Indian and Northern Affairs Canada place particular emphasis on the design and implementation of a rigorous valuation process for assets subject to transfer in land claims settlements when it drafts its action plan to address the findings and recommendations of the Auditor General of Canada.

The Auditor General expressed concerns about the length of time that it takes to negotiate settlements, which in some cases has amounted to twenty years. As he testified, “protracted settlements do not contribute to cost effectiveness and may result in less desirable outcomes for all concerned.” (14.40) There are factors beyond the Department’s control, which can produce a lengthy process, and there is no clear guideline on what an ideal timeframe might be. However the audit found several deficiencies in the management of the claims process for some settlements, which contributed to lengthy negotiation. (14.63)

Departmental witnesses also expressed concerns about the time it takes to negotiate treaties but said that improvements are taking place. They pointed out that since 1986, framework agreements have established responsibilities and timetables, but that these can change over the course of a negotiation. Nevertheless, a commitment was made to focus on this concern in order to find solutions (16.00) and Mr. Serson testified that the Department is exploring ways to accelerate the treaty negotiation process with its partners. (14.40)

The Committee agrees with the Auditor General that lengthy negotiations are detrimental to cost effectiveness and recommends:

That Indian and Northern Affairs Canada include specific proposals to expedite the settlement negotiation process in its draft action plan.

The audit revealed gaps in the Department's monitoring and evaluation of, and reporting on, the implementation phase of settlement agreements. The monitoring conducted by the Department tended to focus on activities and processes, rather than on results and costs. Evaluations examined by the Auditor General did not cover all key implementation aspects and had not been carried out on a timely or periodic basis. As a consequence, reports on settlement agreements do not contain the full range of information needed to properly assess implementation.

The Committee agrees with the Auditor General that settlement agreements by themselves cannot be considered successful resolutions of claims unless they are properly implemented. In order for this to happen, the Department must assiduously monitor implementation, conduct thorough evaluations, and report on the results. Accordingly, the Committee recommends:

That in its draft action plan Indian and Northern Affairs Canada specify how it will improve its monitoring and evaluation of, and reporting on, the implementation of comprehensive land claims settlements.

The Audit demonstrates that the Department could provide a more detailed reporting of the costs of reaching and implementing land claims settlements. For its part, the Department asserts that it already "meets all the usual requirements in terms of disclosure to Parliament," but that it is "prepared to undertake a review" of its financial cost projections to see if improvements can be made. (1545) The Committee believes that both the Department and Parliament need more complete cost information in order to determine the effectiveness of the claims process and therefore recommends:

That Indian and Northern Affairs Canada report the complete costs of reaching and implementing comprehensive land claims settlements in its annual Performance Reports, beginning with the Report for the period ending 31 March 1999. These costs should include the potential value of transferred land ownership and access rights, consolidated costs of other federal departments involved in the process, costs of various projects under implementation plans and responsibilities under the agreements, and costs of revenue and resource sharing. Where actual costs cannot be determined, this should be disclosed and estimates provided instead.

During the meeting, some Members of the Committee expressed strong concerns that non-parties to land claims settlements are affected by agreements but not adequately included in consultations. In his Report, the Auditor General draws attention to the lack of input afforded certain types of enterprise in affected areas in decisions on land allocation and other provisions in settlement agreements. (14.100) A successful land claims process depends on the support of all of those directly affected by the outcome. The Committee therefore recommends:

That Indian and Northern Affairs Canada design a strategy for closer consultation with non-parties in the land claims process in areas affected by settlement agreements. This strategy must include an implementation timetable and a discussion of how the Department will respond to the concerns of non-parties, and be submitted to the Committee by 31 May 1999.

Conclusion

The comprehensive land claims process is clearly a complex one that affects the lives of many Canadians, Aboriginal and non-Aboriginal alike. It is thus incumbent upon all participants in the land claims settlement process to ensure that it is carefully managed. Indian and Northern Affairs Canada, which represents the federal government and has fiduciary responsibilities for Aboriginal peoples, has important responsibilities to ensure that the process is fair, transparent, and skillfully managed. The Committee is confident that the Department, in preparing its action plan, will clarify how it balances the interests of those it represents and will carefully address the Committee's concerns as well as those of the Auditor General, thereby enabling it to better fulfill its responsibilities.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meeting Nos. 46 and 54*) is tabled.

Respectfully submitted,

John Williams,

Chair

REPORT TO THE HOUSE

Wednesday, 10 March 1999

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-THIRD REPORT

The Standing Committee on Public Accounts has considered Chapter 20 of the December 1998 Report of the Auditor General of Canada (*Preparedness for Year 2000 — Government-Wide Mission-Critical Systems*) and the Committee has agreed to report the following:

Introduction

Canadians are becoming increasingly aware of the risks and challenges associated with the Year 2000 problem. It is anticipated that this problem, also known as Y2K or the Millennium Bug, may seriously disrupt some computer- and microprocessor chip-based electronic systems on 1 January 2000.

As Canada's largest corporate entity, the federal government possesses a large number of systems that may be potentially affected by the Y2K problem. The government relies on these systems to deliver a vast array of vital services to Canadians and to support its internal operations. As a consequence, the repair or replacement of non-compliant systems before 1 January 2000 has become an urgent matter. Collectively, the effort to identify affected systems, to repair or replace them, and to develop contingency plans for the delivery of services supported by non-compliant systems is complex, time-consuming, and very costly.

The Committee has taken an active interest in the state of the federal government's Y2K preparedness since the Auditor General first raised the issue in Chapter 12 of his April 1997 Report (*Information Technology — Preparedness for Year 2000*), tabled in October 1997. The Committee has held several meetings on this issue and issued a report with recommendations aimed at strengthening the federal government's ability to address the problem.

In his Report of December 1998, the Auditor General included the results of an audit centred on the preparedness of Government-Wide Mission-Critical (GWMC) systems, or systems that, according to the government's definition, support any service or function performed by the federal government department or agency that directly affects the health, safety, security, or economic well-being of Canadian residents or their environment; the loss or interruption of which, even for a short period, is deemed to be an unacceptable risk.

Due to the important nature of the services dependent upon these systems and the Committee's ongoing interest in the government's Y2K preparedness as a whole, the Committee met on 9 February 1999 with Mr. Denis Desautels, FCA, the Auditor General of Canada, and members of his staff to discuss the results of his audit. Ms. Linda Lizotte-MacPherson, Chief Information Officer, MR. Guy McKenzie, Assistant Secretary, Year 2000 Project Office, Mr. Jim Bimson, Director General, Departmental Readiness, Year 2000 Project Office, and Mr. Richard B. Fadden, Assistant Secretary, Government Operations Sector, appeared as witnesses on behalf of Treasury Board Secretariat.

Observations and Recommendations

In his opening statement and throughout his testimony, the Auditor General stressed that the government had made significant progress since the time of his last audit. For example, he noted that the government has reacted

favourably to the observations and recommendations contained in his 1997 Audit. (1535) Departments and agencies have now assigned top priority to the issue and overall, the pace of Year 2000 work has accelerated. He also indicated that progress had been made in the GWMC systems that were the subject of his recent audit. Toward the end of his statement, the Auditor General testified that he and his Office were "cautiously optimistic," but that they "remain guarded because slippage and unexpected problems can occur and the last 10% can be difficult to achieve on a timely basis." (1545)

The Chief Information Officer (CIO) updated the June 1998 data that had served as the basis for the Auditor General's most recent examination. This information confirmed that progress is continuing and that the pace of work has picked up. For example, the CIO testified that as of January 1999, the overall readiness of GWMC functions stood at 84%, up by 34% since the Auditor General's last (1998) audit. She stated that certain key functions such as Old Age Security, Employment Insurance, the Canada Pension Plan, and the Customs Border Systems are now Year 2000 ready. (1545) GWMC departments and agencies are also achieving progress in developing contingency plans for those functions that may not be ready in time. Ms. Lisotte-MacPherson also described the actions being taken by the federal government to communicate information on the state of the government's internal Year 2000 readiness.

The Committee welcomes this progress but like the Auditor General, is cautious in its optimism. Although headway is being made, any conclusion that the problem has been resolved would be premature and lacking in supporting evidence. Continued scrutiny on the part of the Auditor General, the Treasury Board Secretariat's Year 2000 Project Office, parliamentarians, and Canadians is clearly called for. In order to exercise this scrutiny — and to avoid unfounded speculation — all concerned must have information that is accurate and timely, and available at an appropriate level of detail.

In its first Report on this issue, this Committee called for improved communication of information to Parliament on the government's Year 2000 preparedness. Since that time Treasury Board Secretariat has started to post this information on its web site and has recently begun to update this information as it relates to GWMC departments and agencies. It has also begun to produce, as of January 1999, a monthly report on the government's state of readiness that encompasses all GWMC departments and agencies. These steps — which involve the formatting of information and the frequency with which it is reported — are all moves in the right direction.

Nevertheless, the Committee firmly believes that there are further improvements that must be made in terms of the content of the information that is being communicated. For example, information on the progress being made by GWMC departments and agencies is expressed in terms of three percentages. Two of these show the percentage of work completed by a given GWMC department in two areas: information technology and embedded systems. A third percentage is said to represent the department's overall rate of progress. It should be noted that provision of data on embedded systems responds to a recommendation in the Auditor General's December Report and represents an important improvement.

While these data are useful, they represent an aggregate or "roll-up" of other percentages showing work completed on the systems that support the 48 functions delivered by GWMC departments and agencies. In those instances in which a department delivers only one GWMC function, actual progress can be determined easily and quickly. Some departments, however, deliver as many as five functions. In these cases, it is not possible to determine the degree of progress being made toward compliance for each function.

In her testimony, Ms. Nancy Cheng of the Office of the Auditor General observed that the current progress report "does not get down to the mission-critical function level, which is where perhaps that would be more meaningful for [the Committee] to understand which functions are ahead and which functions are perhaps behind." (1625) The Committee notes that Treasury Board Secretariat has this information. Ms. Lizotte-MacPherson testified that the departments do report on a system-by-system basis and then Treasury Board Secretariat aggregates this information at the department level. (1630) Mr. Jim Bimson acknowledged that the Secretariat does have the information by function. (1630)

There is one other way in which the percentages now used to report work completed do not allow for a detailed understanding of the actual progress being made. In order to measure progress, Treasury Board Secretariat uses methodology developed by the GartnerGroup. This methodology breaks the work down into seven phases (Awareness; Inventory; Project Scoping; Analysis and Design; Repair; Testing; and Implementation). These phases require different degrees of effort before they can be completed. It is universally recognized, for example, that Testing, the penultimate phase requires 45% of the total effort. Furthermore, as the CIO testified, the last 10% of the work "will probably be the most difficult." (1630) Thus aggregating these figures does not foster a full understanding of the work remaining to be done — or an appreciation of the work actually completed.

In its first report to this Committee, which showed government Year 2000 readiness as of fall 1997, Treasury Board Secretariat provided progress information on each one of the seven phases for all GWMC departments. It did so again (although somewhat belatedly) when it reported readiness as of September 1998. In its report covering December 1998, however, the Secretariat dropped this practice and moved to aggregate percentages instead. This change, it should be noted, was made without consulting this Committee and without explanation.

In his closing comments, the Auditor General observed that "it is always possible to provide more information and provide it differently." He also said that "there would be some advantage to providing more information, . . . , on the actual functions as opposed to an average by department." (1720) The Committee believes that there is a need for more detailed information at the level of mission-critical functions and therefore recommends:

That, as of March 1999, when Treasury Board Secretariat reports on the Year 2000 readiness of Government-Wide Mission-Critical departments and agencies, it report progress within each of the seven GartnerGroup phases for each of the 48 Government-Wide Mission-Critical functions.

There is one other way in which the information in these monthly progress reports should be improved. In his testimony, the Auditor General noted that central monitoring does not cover the preparedness of Department-Wide Mission-Critical (DWMC) systems, systems that are essential to departments and agencies so that they can continue to carry out their mandates. (1540) He highlighted the importance of monitoring these essential mini-systems by pointing to the telephone system within his own Office. This system, initially thought to be Year-2000 ready, was later found to be non-compliant and has now been repaired. (1620)

In his testimony, Mr. Guy McKenzie stated that departments are now fixing their departmental mission-critical systems and that the Project Office was about to begin quarterly reporting on progress in that area. (1655) Mr. Jim Bimson added that the Project Office would soon have some data on Department-Wide Mission-Critical systems and would begin to look at these systems on a monthly basis. He indicated that the focus on these systems would increase as GWMC systems move to full compliance. (1655) The Committee welcomes these steps and recommends:

That Treasury Board Secretariat work with departments and agencies to identify Department-Wide Mission-Critical systems, begin monitoring the preparedness of these systems monthly, and report progress at the departmental level against each of the GartnerGroup phases starting with its monthly progress report in April 1999.

In their attempts to inform Canadians, the Treasury Board Secretariat appears to have overlooked the important role that Members of Parliament play in imparting information on government to their constituents. The Committee notes that in December 1998 the President of Treasury Board provided all parliamentarians with a Year 2000 information kit. It also notes that the CIO has made a commitment to supply the Committee with monthly progress reports. These measures represent an appropriate response to the information needs of parliamentarians, but more must be done. Accordingly, the Committee recommends:

That Treasury Board Secretariat immediately develop and implement a communications strategy designed specifically to inform all Members of Parliament, on at least a monthly basis, of the state of federal government preparedness for the Year 2000.

The Committee further recommends:

That Treasury Board Secretariat immediately designate an individual within its Year 2000 Project Office who will be available to Members of Parliament to provide information and answer questions regarding the state of federal government preparedness.

Conclusion

This year, 1999, marks a crucial period as 1 January 2000 approaches. There is much that remains to be done in the short time remaining before this unavoidable deadline if the systems that support the delivery of government services are to continue functioning into the new century.

Rather than seeking reassurance in the progress that has been made, those who bear responsibility must redouble their efforts and avoid the dangers of complacency. They must also attend to the delicate but necessary task of ensuring that Canadians are provided with accurate, timely, and complete information on the federal government's own state of preparedness for the Year 2000. A successful conclusion to this challenge rests, among other things, upon meaningful accountability supported by an appropriate degree of transparency. For its part, the Committee will continue to monitor progress and press for improvements as necessary.

The Committee believes that adoption of its recommendations will assist Canadians and their Members of Parliament understand the challenges involved and be fully prepared as they enter the new century.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meeting Nos. 52 and 54*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Tuesday, 16 March 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-FOURTH REPORT

The Standing Committee on Public Accounts has considered Chapter 27 of the December 1998 Report of the Auditor General of Canada (*Grants and Contributions: Selected Programs in Industry Canada and Department of Canadian Heritage*) and the Committee has agreed to report the following:

Introduction

Grants and contributions are part of government expenditures known as transfer payments, which are payments of money from the federal government to individuals and organizations of various types, such as businesses or other levels of government (27.7).

The federal government spent a total of \$39.5 billion in grants and contributions in the 1998–1999 fiscal year (27.10). This represents approximately a quarter of the federal government's expenditures for that period.

Grants are unconditional transfers, that is, they do not require the recipient to meet future performance requirements once the eligibility and entitlement requirements are met.

Contributions, on the other hand, are transfer payments subject to performance conditions that are specified in contribution agreements. In order to be reimbursed for specific costs over the life of the agreement, the recipient must continue to show that the performance conditions are met (27.8). Unlike grants, the federal government can usually audit contributions.

Over the past 21 years, the Office of the Auditor General (OAG) has carried out several audits on the management of grant and contribution programs throughout federal departments and agencies. These audits identified persistent and consistent shortcomings ranging from problems in compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient performance control and reporting.

The Office of the Auditor General (OAG) attributes these persistent problems to weak management practices, such as difficulty in setting clear and attainable goals, problems in exercising due diligence and measuring performance (27.23). The OAG noted in subsequent follow-up audits specific improvements in some areas but problems still persist each time the OAG audited grant and contribution programs (27.22).

It was in the context of this issue that the Standing Committee on Public Accounts decided to consider the findings and observations in Chapter 27 of the December 1998 Report of the Auditor General of Canada on grants and contributions: selected programs in Industry Canada and Department of Canadian Heritage. The Committee met on 11 February 1999 with Mr. Denis Desautels (Auditor General of Canada) and Mr. Peter Simeoni (Principal, Audit Operations Branch). Representing the Department of Canadian Heritage were Mr. Norman Moyer (Assistant Deputy Minister, Canadian Identity) and Ms. Anne Scotton (Director General, Corporate Review). Ms. Diane Vincent (Assistant Deputy Minister, Operations Sector) and Mr. Michael Binder (Assistant Deputy Minister, Spectrum, Information Technologies and Telecommunications) represented Industry Canada.

Observations and Recommendations

In his opening statement, the Auditor General of Canada, Mr. Denis Desautels, made the following observation: that twenty-one years of auditing federal grant and contribution programs have uncovered persistent and consistent weaknesses. Significant opportunities remain to improve the management of the Multiculturalism Program of the Department of Canadian Heritage and the Ontario Base Closure Adjustment Program (OBCAP) delivered by Industry Canada. Industry Canada could also strengthen its accountability for performance under its contribution agreements with CANARIE (Canadian Network for the Advancement of Research, Industry and Education), and PRECARN Associates Inc., which stands for pre-competitive advance research network (1535).

The weaknesses found were in the areas of compliance with program authorities, program design, control, performance measurement and reporting. The persistence of these problems, according to the Auditor General, is partially attributable to decision makers not following the government's own rules on grant and contribution programs and weak management practices (1535). To address the problem of weak management practices, the Office of the Auditor General is currently developing and will soon publish a performance management framework that will set out expectations of management and assist managers to think critically about their programs (1535).

The Auditor General indicated that the present audit focussed on a critical management issue of what constitutes due diligence in assessing applications for grants and contributions. According to the Auditor General, due diligence means ensuring that funding decisions take into account the funding criteria set by the Treasury Board and that they are based on reliable information (1537).

The present audit focussed on the direct delivery of grants and contributions under the Multiculturalism Program of the Department of Canadian Heritage and the Ontario Base Closure Adjustment Program (OBCAP) of Industry Canada. Also considered in the audit was Industry Canada's management and administration of indirect delivery of contribution programs.

At the end of the audit, there remained three principal issues that still needed to be addressed. First of all, a clearer definition of expected results is required in order to assess whether grant and contribution programs achieve their intended goals. Second, application of due diligence to ensure that all funded projects represent value-for-money to both the applicant and the program. Thirdly, a review of the accountability arrangements and performance expectations for indirect delivery of grant and contribution programs (1543).

The witness representing the Department of Canadian Heritage, Mr. Norman Moyer, fully agreed with the Auditor General's recommendations regarding the Multiculturalism program, particularly in the areas of clarifying program objectives, the application of due diligence in assessing, monitoring and evaluating projects, and the proper reporting of program performance (1550).

The witness for Industry Canada, Mrs. Diane Vincent, welcomed the Auditor General's proposal to develop a performance management framework for grant and contribution programs and indicated to the Committee that Industry Canada would gladly collaborate with the Office of the Auditor General in further developing this framework (1555).

Several times during the meeting, Committee Members expressed concerns regarding the vagueness of performance expectations of certain grant and contribution programs, particularly under the Multiculturalism Program delivered by the Department of Canadian Heritage. Evaluation of program effectiveness and assessment of value-for-money is difficult, if not impossible, to undertake without clearly stated and focussed goals and expected results.

This prompts the Committee to support the following recommendations:

That the departments clarify all grant and contribution program objectives, and include them in their annual Performance Reports to Parliament for the period ending 31 October 1999.

That the departments begin to report actual outcomes against the expected results in their performance reporting to Parliament, beginning for the period ending 31 March 2000.

Committee Members also expressed concern about how departments managed and monitored their grant and contribution programs. The Auditor General's Report found many examples where the Departments of Canadian Heritage and Industry Canada could have demonstrated more diligence in how they administered, documented, evaluated, and carried out the assessment of grant and contribution programs under their responsibility.

Particularly, for Industry Canada, the audit found many opportunities to improve the accountability for performance under its indirect delivery of contribution programs (i.e. CANARIE Inc. and PRECARN Associates Inc.). For example, business and operating plans provided by third parties could include annual performance expectations by which the department could monitor the performance of third party delivery of grant and contribution programs.

As a result of these concerns, the Committee recommends the following:

That the departments review the decision-making processes for all grant and contribution programs and that they ensure that all eligible applications for funding are assessed against the criteria approved by the Treasury Board.

That the departments audit periodically all of their grant and contribution programs and report the results of these audits in their annual performance report to Parliament, beginning fiscal year 2000–2001.

That Industry Canada review all accountability arrangements of its indirect program delivery, assess their performance and report the results in their annual performance report to Parliament, beginning fiscal year 2000–2001.

While acknowledging the efforts already undertaken by the various departments in addressing the issues raised by the Auditor General, the Committee remains concerned about the persistence of the problems regarding the management and administration of grant and contribution programs. Since 1977, audits of grant and contribution programs have identified the same problems: weakness in program design, examples of poor controls, insufficient performance measurement and reporting. Although specific examples of improvements exist, the Office of the Auditor General continues to find the same consistent and persistent problems each time they audit grant and contribution programs (1535).

In view of the persistence of the problems associated with grant and contribution programs, the Committee does not believe that gradual reform is sufficient to address the issues identified in over two decades of audits. A more comprehensive approach is required. Thus the Committee strongly suggests that:

The Office of the Auditor General of Canada consider undertaking a comprehensive audit of the management of grant and contribution programs and that it report its conclusions and recommendations to Parliament.

Conclusion

Grant and contribution programs require immediate attention given their size relative to other federal government expenditures and their potential impact on the welfare of Canadians. The Committee believes that the proposed recommendations provide the first critical steps to deal with the outstanding issues that have to date impeded the proper functioning of these programs and will go a long way to ensure better accountability to Parliament and to Canadians in general.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meeting Nos. 53 and 56*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 5 May 1999

The Standing Committee on Public Accounts has the honour to present its

TWENTY-FIFTH REPORT

In accordance with its Order of Reference of Monday, March 1, 1999, your Committee has considered Votes 25 and 30 under FINANCE of the Main Estimates for the fiscal year ending March 31, 2000 and reports the same.

A copy of the relevant *Minutes of Proceedings* (*Meeting No. 59*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 5 May 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-SIXTH REPORT

The Standing Committee on Public Accounts has considered Chapter 24 of the December 1998 Report of the Auditor General of Canada (*Revenue Canada – International Tax Directorate: Human Resource Management*) and the Committee has agreed to report the following:

Introduction

Established in November 1991, the International Tax Directorate was created to enhance Canadian businesses' competitiveness and to protect the Canadian tax base by ensuring compliance with Canadian legislation applying to non-residents and to international transactions.

International tax is a growing field with a significant potential for tax revenues for Canada (24.19). At the same time, given the complexity of the concepts and issues involved in the international tax field, there is also a serious possibility of loss of revenues if risk to the tax base is improperly managed. In this complicated, knowledge-intensive area, the International Tax Directorate requires a stable work force of highly skilled professionals to properly manage the risk to the tax base (24.22).

The audit focused on the human resource management of Revenue Canada's International Tax Directorate and how well it attracts, motivates and retains well-qualified and trained staff who can perform effectively and to a high standard.

With these issues in mind, the Standing Committee on Public Accounts decided to consider the findings of Chapter 24 of the December 1998 Report of the Auditor General of Canada. (*Revenue Canada – International Tax Directorate: Human Resource Management*). The Committee met on March 23, 1999 with Mr. Denis Desautels, FCA (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General) and Mr. Barry Elkin (Principal, Audit Operations Branch). Representing Revenue Canada were Mr. Barry Lacombe (Assistant Deputy Minister, Verification, Enforcement and Compliance Research Branch) and Mr. David Brown (Director General, Human Resources Agency Team).

Observations and Recommendations

In his opening remarks, the Auditor General stated that human resource issues in the International Tax Directorate (the Directorate) needed much attention. "Weaknesses in human resources management in the Directorate, coupled with the often cumbersome human resource management rules in the Public Service, have resulted in long delays in the staffing process." (1540). The audit noted that the Directorate's staffing process was slow, and that it took an unusually long time to mark examinations and establish eligibility lists. Good candidates may lose interest if they have to wait for long periods of time. At the time of the audit, the Directorate was still developing a comprehensive plan and human resource strategies linked to its business plan, even though it recognized as far back as 1994 the urgent need for a human resource plan. (24.41)

The Directorate will need to have a robust human resource strategy to ensure that, as senior level personnel retire or transfer, their positions are filled with competent, experienced people. To support the implementation of this

strategy, a reliable human resource information system will be needed. Revenue Canada has acknowledged the need throughout its organization for a reliable human resource information systems and databases. (24.38)

The audit noted the Directorate's high rate of staff turnover, low average levels of experience, and many key positions being filled using secondments, redeployments and acting assignments. The Auditor General stated that "this approach to staffing has resulted in a lack of stability and continuity and may pose a risk to the quality of work". (1540)

Given that the Directorate's staff is expected to interact with highly experienced and skilled senior people in the largest corporations and with tax professionals in the private sector and other governments, they are expected to exercise good judgement when interpreting complex transactions and complex tax laws. Attracting and maintaining the necessary workforce can be achieved through developing the current workforce, hiring new people with the right skills and providing a suitable environment that enables personal growth and career progression.

The Auditor General closed by observing that the solutions to the problems rest solely with the Department. Revenue Canada must develop a plan to hire, retain and train key employees. (1545) The move to the proposed Canada Customs and Revenue Agency should not be considered as a panacea for outstanding human resource management issues.

In his opening statements to the Committee, the Assistant Deputy Minister for Revenue Canada, Mr. Barry Lacombe, indicated that the Auditor General's observations and recommendations supported and reinforced the Directorate's own comprehensive action plan to address human resources problems. Mr. Lacombe discussed the Directorate's progress in staffing management positions and also described a set of initiatives to ensure that it has a qualified and well-trained work force. For example, the Directorate established an accelerated development program for its auditors to be piloted this year. It also plans to introduce a self-directed career development program to ensure the internal development of management expertise. The Assistant Deputy Minister also indicated progress in the development of a human resource management plan together with updated information systems to support this plan.

In contrast to the Auditor General's position, the Department feels that the move towards Agency status, while not a universal cure-all, will allow for greater flexibility to tailor the Department's human resources strategies to meet the business requirements of the International Tax Directorate. The Department maintains that the effort it has put into upgrading its planning and accountability systems addresses in a global sense the issues raised in the audit. Upgraded human resource management systems will be incorporated into the new agency. The witness stated that: the creation of the Canada Customs and Revenue Agency will strengthen the link between human resource plans and business plans. That linkage, we believe, will be an integral feature of the overall departmental planning process. This will allow the agency to better predict its human resource requirements, so that it can take the necessary actions on a proactive basis. (1555)

The Committee then asked for the Auditor General's opinion on the ability of the Directorate's action plan to correct the human resource problems. Mr. Shahid Minto, Assistant Auditor General, answered that the audit team was very comfortable with the action plan's objectives and intentions. The real question was whether these were matched by effective actions. Mr. Minto added that the implementation of the action plan performance would be monitored.

Some Committee Members wondered about the potential impact on human resource planning if Revenue Canada became an Agency. The Auditor General acknowledged that management of human resources at Revenue Canada was a very challenging activity, particularly in the hiring of new staff. The move towards agency status would undoubtedly provide greater flexibility in managing human resources, but the Department could considerably improve its management by speeding up its own internal hiring process. (1630)

When questioned about the causes underlying the long delays in filling positions in the Directorate, Mr. Lacombe stated that it was partly due to the slowness in the Department's own internal staffing procedures and to the external appeals process. (1640)

The Director General of the Human Resources Agency Team, Mr. David Brown, indicated that it took an average of 166 days to complete a closed competition. An average of 90 days would be added if the staffing decision was appealed.(1650) Mr. Lacombe mentioned some cases where the appeal process had lasted over two and a half to three years.(1645)

While agreeing with the Auditor General's position that the Department could speed up its own internal staffing process, Mr. Lacombe felt that the move towards agency status would bring additional flexibility to human resource management.

In his participation in the Canada Customs and Revenue Agency project, Mr. Lacombe mentioned that he had had discussions with organizations that had similar problems with their appeals process. He stated that some of these organizations addressed this issue by adopting a less formalized process that, in some cases, shortened the duration of appeals down to thirty days (1645).

After listening to the testimony concerning the Directorate's management of human resources, the Committee urges the Directorate to immediately address all the internal issues before the eventual move towards the Customs and Revenue Agency status and therefore recommends:

That Revenue Canada's International Tax Directorate complete the implementation of its comprehensive action plan that links its human resource management plan to its business plan.

That Revenue Canada's International Tax Directorate include in its annual Performance Report to Parliament, starting 31 October 1999, an implementation report of its comprehensive action plan, containing a detailed list of planned initiatives together with their implementation timetables.

That Revenue Canada's International Tax Directorate complete the implementation of its Corporate Administration System (CAS) project, consisting of upgrading and updating the human resource information systems and databases to support the human resource management plan, and inform Parliament of the progress of this project through the Department's annual Performance Reports.

Conclusion

The Committee believes the human resource management at Revenue Canada's International Tax Directorate is an important issue that needs to be addressed given the potential tax recoveries for Canada. While the Committee recognizes that part of the problem is external, this should not prevent the International Tax Directorate to immediately undertake improvements to its internal staffing procedures. The Committee feels that human resource management issues need to be addressed regardless of Revenue Canada's decision concerning the planned Canada Customs and Revenue Agency.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 58 and 61*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 5 May 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-SEVENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 25 of the December 1998 Report of the Auditor General of Canada (*Transport Canada – Investments in Highways*) and the Committee has agreed to report the following:

Introduction

The federal government makes transfer payments to the provinces and territories to improve the Trans Canada and provincial highways, to promote safety, and to encourage economic and regional development. The federal government, through Transport Canada, has spent over \$ 1.6 billion dollars worth of investments in provincial-territorial highways over the last ten years. These investments were mostly administered through a series of ad-hoc programs.

At the time of the audit, Transport Canada was involved in 24 multi-year cost-sharing agreements with provinces and territories, largely under seven separate highway investment programs. These programs are, in effect, contribution programs where continued federal funding is conditional on the compliance and performance of the applicable federal-provincial-territorial agreements.

The goal of the audit was to determine how well Transport Canada has managed, administered and reported on its highway investment initiatives. The Auditor General also assessed the department's performance in discharging its other responsibilities related to overall federal spending on highways.

It was in the context of these issues that the Standing Committee on Public Accounts decided to consider the findings of Chapter 25 of the December 1998 Report of the Auditor General of Canada (*Transport Canada – Investment in Highways*). The Committee met on the 16 March 1999 with Mr. Denis Desautels (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General) and Ms. Basia Gadomski-Ruta (Principal responsible for Transport Canada). Ms. Margaret Bloodworth (Deputy Minister), Mr. Louis Ranger (Assistant Deputy Minister, Policy), Mr. Ron Sully (Assistant Deputy Minister, Programs and Divestiture) and Mr. Ralph Jones (Director, Surface Programs) represented Transport Canada.

Observations and Recommendations

In his opening statement, the Auditor General summarized the audit findings under six principal headings. First, the National Highway Transportation Policy is twenty-five years old and has never been updated. Second, information supplied to decision makers has not always been accurate or complete. Third, federal review to support project approval lacks rigour. Fourth, there is poor record keeping and little monitoring and analysis to support highway investment decisions. Fifth, the audit found instances in which, contrary to federal statutory requirements, payments were made before the required environmental assessments were completed. And finally, during the last five years, the department assigned only nine people to deliver its highway investment programs and to administer 24 federal-provincial highway agreements, involving the review, approval, monitoring and reporting on over 600 projects and many more construction contracts. The audit found that the department did not do much of what it was supposed to do under the agreements (1540).

The Auditor General further noted that Transport Canada has yet to conduct a formal evaluation of its highway investment program despite the fact that it has been involved in making federal-provincial highway investments for many years. The Auditor General was concerned that the Department lacked key information it requires to plan for the future and to make informed recommendations to government when it considers new highway investment initiatives.

The Auditor General also raised the issue of tolls. Although tolls have been applied for almost ten years, none of the federal-provincial agreements dealt with the issue until recently, nor has federal policy been amended to address the matter. Furthermore, Transport Canada has yet to complete any analysis of the impacts of tolls or transfers of highways to the private sector on traditional funding arrangements and other matters. Given the \$1 billion dollars' worth of investment already spent, the increased public interest in the matter and the federal commitment to spend several hundred millions dollars more over the next few years under the existing federal-provincial agreements, a clear position on the matter is essential.

In conclusion, the Auditor General noted that Transport Canada had committed itself to a number of initiatives to deal with many of the concerns identified by his audit and stated that he found the Department's response encouraging (1545).

Ms. Margaret Bloodworth then described the various initiatives undertaken by the Department to address the issues outlined in the audit.

Stating that "in general, the administrative framework that is in place for these contribution programs has served both our provincial partners and the federal government well", the witness acknowledged that there was room for improvement, and stated that the Department would adopt many of the Auditor General's recommendations (1545).

Under the heading "Managing programs and administering agreements", Ms. Bloodworth outlined the various steps the department has undertaken to respond to the audit's observations and recommendations. Ms. Bloodworth explained that the administrative agreements contribute money to highway construction and is not directly involved in building of roads, a matter of provincial jurisdiction. She indicated that all improvements to the agreements "will continue to ensure that we perform only those functions necessary to protect the federal financial interest" (1545).

Regarding the national highway policy, Ms Bloodworth quoted the Minister when he appeared before the Standing Committee on Transportation in November 1997. The Minister, Mr. David Collenette, stated that if the federal government decided in the future to invest in highways, he would prefer a more integrated national approach guiding these bilateral agreements, in which the policy objectives of both levels of government are specified. However, no policy decision on continued funding has yet been made by the federal government.

Regarding alternative financing arrangements, the Deputy Minister agreed that the policy on tolls in particular needs to be further updated and clarified. She stated that this matter had been subject of discussions with provinces and territories as part of the work of the Federal/Provincial/Territorial Working Group on Public-Private Partnerships. Ms. Bloodworth informed the Committee that the department is working with the provinces and territories to "ensure that a policy is ready to be included in future highway agreements" (1550).

Some committee members were clearly concerned about the Department's lack of consistent policy direction regarding the treatment of alternative financing arrangements, particularly the treatment of toll highways. The Committee notes that the Department is currently engaged in discussions with the provinces and territories in an effort to clarify policy direction in this area. The Committee believes that these discussions must produce timely results and therefore recommends:

That by 31 march 2000 Transport Canada complete its discussions with the provinces and territories to produce a clear policy direction regarding the treatment of alternative financing arrangements, particularly about the treatment of toll roads.

Once clarification is obtained, that Transport Canada consistently apply this policy to any subsequent federal-provincial agreements that involve alternative financing arrangements.

That Transport Canada develop monitoring systems and practices to ensure that these new policies are properly applied, and report the degree of compliance with these policies in its annual Performance Reports beginning with the period ending 31 March 2000.

The Committee was informed that the federal government had not updated the National Highway Transportation Policy since 1974. Over the last 25 years, a number of substantive events in highway transportation have occurred, especially in the areas of highway financing, safety, and federal/provincial relationships. It is important to establish an up-to-date national highway transportation policy to ensure relevant and adequate guidance for managing Transport Canada's highway investment programs.

Consequently the Committee recommends the following:

That Transport Canada begin a thorough review of the National Highway Transportation Policy with the goal of updating the Policy by 31 March 2000.

That Transport Canada report the results of the review to Parliament by 31 March 2000.

The Committee learned that many federal departments are involved in highway investments. Over the last 10 years, \$ 3.5 billion in highway infrastructure expenditures were carried out by Public Works and Government Services Canada, Agriculture and Agri-Food Canada; Indian and Northern Affairs Canada, Canadian Heritage (Parks Canada); the Canadian Infrastructure Works Program, and Transport Canada. The 1974 National Highway Transportation Policy directed Transport Canada to play a lead role in co-ordinating information on highway investment at the federal level for the government's consideration, and to chair an interdepartmental committee to facilitate the process. The committee was required to prepare a comprehensive annual report on federal spending, as well as plans for potential future involvement in highway projects (25.23).

The interdepartmental committee remained active only until 1985, and the comprehensive annual report was last published in 1990–91 due to lack of resources. In 1992, the federal government reinforced Transport Canada's lead role in co-ordinating information on the condition of federal roads and level of spending. To date, according to the Auditor General, Transport Canada has not fulfilled its lead role of co-ordinating and reporting comprehensive information on federal involvement in highways (25.28).

It was noted that Transport Canada, in its response to the Auditor General's recommendations, committed itself to form and chair an interdepartmental highway committee to co-ordinate information on federal government highway expenditures (25.29).

However, when questioned about the operational status of the interdepartmental highway committee, Ms Bloodworth indicated that it had already been formed but also admitted that, to date, it had not yet met (1705).

In light of the above, the Public Accounts Committee recommends:

That the interdepartmental highway committee immediately start its meetings with its federal department counterparts in order to enable Transport Canada to begin fulfilling its lead role in co-ordinating information on overall federal involvement in highways.

That the interdepartmental highway committee periodically review whether its responsibilities under this role reflects current circumstances, and make recommendations to the government as appropriate.

The audit uncovered many shortcomings concerning Transport Canada's management of highway investment programs and administration of federal/provincial agreements. Examples were found of incomplete or inaccurate information supplied to decision makers, lack of rigour in the project review process, poor record keeping and little monitoring and analysis to support highway investments, information on federally funded highways is incomplete and fragmented across the Department. The audit found instances, contrary to federal statutory requirements, of payments that were made before the required environmental assessments were completed.

Notwithstanding the many weaknesses found in the Department's financial management system, the staffing levels assigned are clearly insufficient to properly deliver the highway investment programs and administer federal-provincial highway agreements. According to the Auditor General, the Department "did not do much of what it was supposed to do under the agreements (1540)".

From the testimony of the witnesses, the Committee noted that the staffing allocated by Transport Canada to manage the highway investment programs and administer the federal/provincial agreements did not permit the Department to fulfil its obligations. Further, the information management systems could not compensate for insufficient staffing levels. The Committee recommends:

That Transport Canada review the level of human resources needed to effectively manage its highway investment programs and to administer federal/provincial highway agreements and that the Department complete this review and report the results to Parliament by no later than 31 March 2000.

That Transport Canada improve its financial information management systems in order to provide better support for an effective management and administration of federal/provincial highway investments and that the Department complete this update and report the results to Parliament by no later than 31 March 2000.

Finally, the Committee is concerned that the legal requirement for environment assessment prior to funding approval for highway investment programs is not always adhered to. In some cases, the audit found that payments were issued to individual projects before the completion of environmental screenings. When questioned about this Ms Bloodworth stated that "we do believe that we have fulfilled all of the obligations with regards to the application of the Canadian Environmental Assessment Act (CEAA) to specific projects (1605)". She also stated that the Department couldn't fully demonstrate compliance to the CEAA, because of incomplete documentation. In contrast, Ms. Gadomski-Ruta of the Office of the Auditor General indicated that the evidence showed that, for some highway projects, payments were indeed issued prior to the completion of the environmental assessment (1615). Given the respective positions of the Department and of the Office of the Auditor General of Canada, the Committee therefore recommends the following:

That Transport Canada develop without delay a centrally located information management system to document the Department's full compliance with the Canadian Environmental Assessment Act (CEAA) and that it present a status report to the Standing Committee of the Public Accounts on the progress of this initiative by 31 May 1999.

Conclusion

The Committee is concerned about Transport Canada's weak performance in managing and administering its highway investment projects. The Auditor General points that "the programs themselves have been managed and

administered more like grant programs than the contribution programs they are (25.03)”. What is apparent is not so much the observed shortcomings in the existing managerial and administrative framework, but rather the Department’s failure to adhere to its own guidelines and rules. While the Committee acknowledges the Department’s current initiatives to address the issues identified in the audit, clearly a more serious effort must be directed to ensuring greater compliance and accountability from Transport Canada’s highway investment programs.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 57 and 61*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 5 May 1999

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-EIGHTH REPORT

The Standing Committee on Public Accounts has considered Chapter 26 of the December 1998 Report of the Auditor General of Canada (Contracting for Professional Services: Selected Sole-Source Contracts) and the Committee has agreed to report the following:

Introduction

As Canada's largest corporate entity, the federal government spends significant amounts of money on contracts for professional services from outside suppliers. In 1995, for example, the government spent approximately \$4.4 billion for this purpose.

The government pays for these services from public funds and the contracts contribute to the overall mix of goods and services that the government provides to Canadians. Seen from this perspective, it is essential that the government obtain the best services at the best cost.

For potential suppliers of services, government contracts represent an important source of income as well as an opportunity to demonstrate and improve their capabilities. There are additional benefits as well that flow to the communities in which suppliers are located. Viewed from this perspective, the importance of making sure that all potential suppliers have fair and open access to government contracts becomes plainly evident.

The needs of the various parties to contracts are recognized in the government's policies that clearly specify that all contracts must be — except in certain tightly defined circumstances — open to competitive bidding. Through reliance on competition among suppliers government satisfies two indispensable principles — that of best value and open access.

Because of the costs and important principles involved, the Committee decided to examine the results of an audit done by the Auditor General of Canada of a selection of sole-source contracts. In theory, these contracts are let to suppliers without competition provided they meet certain criteria. Accordingly, the Committee met on 9 March 1999 with Mr. Denis Desautels, FCA, Auditor General of Canada, Mr. Shahid Minto, Assistant Auditor General, and Mr. Hugh McRoberts, Principal, Audit Operations Branch to discuss the audit findings presented in Chapter 26 of the December 1998 Report of the Auditor General of Canada (Contracting for Professional Services: Selected Sole-Source Contracts). Mr. Colin Potts, Deputy Comptroller General, Mr. Alan Winberg, Assistant Secretary, Risk, Procurement and Asset Management Sector, and Mr. R.J. Kelly, Director of Contract Policy Division, appeared on behalf of Treasury Board Secretariat.

Observations and Recommendations:

Government policy regarding the letting of sole-source contracts is a clear indication that the principles of best value and open access are paramount and that this form of contracting must be the exception rather than the

rule. This policy is expressed in the Government Contract Regulations and in the Treasury Board Secretariat's Contracting Policy, which establish the four exceptions under which competitive bidding can be set aside in favour of sole sourcing. Thus, according to regulation, departments can only sole source a contract when:

1. there is a pressing emergency;
2. the contract is valued at less than \$25,000;
3. it is not in the public interest to solicit bids; or
4. only one person (firm) is capable of performing the work.

These four circumstances provide the only exceptions under which contracts may be sole-sourced. When these exceptions prompt a decision to sole-source, policy requires that there be a full justification. In previous reviews, both the Auditor General and the House of Commons Standing Committee on Government Operations reached the conclusion that these exceptions and the other regulations surrounding contracting are sound.

In order to verify compliance with the rules for sole-source contracts, the Office of the Auditor General audited a sample of 26 sole-sourced contracts with an initial value of \$16 million from five departments.

The Auditor General summarized the results of the audit in his opening statement. In the cases examined, the evidence suggests that there was little preliminary analyses done before decisions were taken to sole-source, that two-thirds of the contracts examined did not satisfy the exemptions and thus should have been open to competition, that in most cases management had not taken sufficient measures to ensure that the price paid was reasonable, and that in 17 of the cases there was inadequate documentation to show that the contracted services were delivered on time and at an acceptable level of quality. (1540) Mr. Desautels concluded his statement with a strong endorsement of current contracting regulations and the principles of best value and open access that underlie them.

The Deputy Comptroller General agreed that the current regulations are sound and the introduction of new rules would not be appropriate. He stressed, however, that there are clear divisions of responsibility with regard to contracting. Treasury Board Secretariat establishes the policy framework; departments alone are responsible for implementing it. Mr. Potts then produced data showing that both the number and value of contracts above \$25,000 that are competitively tendered has been increasing. For example, from 1993 to 1995 competition averaged at around 63 to 65% by value and number of contracts above \$25,000. For 1997, 89% of the value and 82% of the number of contracts above \$25,000 were competitive. Mr. Potts also asserted that Canada compares quite favourably with its trading partners with respect to its contracting practices. Mr. Potts concluded by outlining some of the steps that the Secretariat is taking to strengthen the contracting process. These steps include reforming and modernizing procurement, developing training and certification programs for those engaged in procurement, and establishing a mandatory orientation on procurement policy, principles, values and best practices for Responsibility Centre Managers involved in procurement. Additional measures include improving access to procurement information and strengthened monitoring.

Later on, in testimony, Mr. Winberg elaborated on some of these measures. He indicated that the Secretariat is putting in place a framework for evaluating contracting activities that will be implemented by internal audit groups in the departments. He further stated that the Secretariat would be assessing those departments that appear to be exceeding the norm in terms of percentages of sole-source contracts being let. Those departments whose sole-source contracts fall below the norm will also be contacted as a follow up. Lastly, the Secretariat is looking at ways to improve the accessibility and timeliness of contracting information. (1655) Mr. Potts made a commitment to provide a report to the Committee by mid-April detailing these and other measures. (1650, 1705)

In general, the Committee welcomes this series of initiatives but believes that additional measures must be taken to address problems identified by the audit. The Committee also welcomes the assertion that the number and value of sole-source contracts valued above \$25,000 are declining. At the same time, however, the Committee notes that the data presented are unaudited and may rest upon disputed definitions of "competitive." When contracts are sole-sourced, departments may announce their intention to do so by issuing an Advance Contract Award Notice or

ACAN. These notices inform potential suppliers that a decision to sole-source is imminent and offers them fifteen days in which to contest the decision. If no objections have been received during that time, the contract is then deemed to have been competitively let. The Auditor General stated unequivocally that the issuance of ACANs lend transparency to the process but does not make contracts let without tender competitive. (1550) Thus data that show progress in this area must be treated with caution because contracts that have been deemed competitive on the basis of the issuance of an ACAN have been included.

The Committee has some particular concerns with regard to the role of Treasury Board Secretariat in the contracting process. The first has to do with the monitoring and assessment of, and reporting on, departmental contracting activity. Section 5.1 of the Secretariat's Contracting Policy deals with monitoring and states that in terms of reporting mechanisms and indicators:

Two mechanisms will be used: departmental audits and an annual report on contracting. Departments will be evaluated on their compliance with contracting policies and the level of competitive contracting. All departments and agencies awarding contracts and/or amendments are required to submit an annual report to the Treasury Board Secretariat on all contracting activities.... The Treasury Board Secretariat also conducts periodic reviews of contracts for the services of individuals, including those for less than \$5,000.

At the time of the audit, the most recent Annual Contracting Activity Report from Treasury Board Secretariat was for calendar year 1995. (26.13) Following completion of the audit, the Secretariat posted unaudited data on contracting for the 1996 and 1997 calendar years on its Internet site in December 1998. Mr. Winberg told the Committee: "Every year we [the Secretariat] look at the contracting figures that come in from the departments on their contracting activity and we publish them on the Internet." (1640) As noted earlier, he also testified that the Secretariat is exploring ways to provide this data on a more timely basis.

In his Report, the Auditor General indicates that the Secretariat was asked for its own assessments of departmental compliance, and particularly its reviews of contracts for the services of individuals. He reports that his Office was told that no such assessments and reviews exist. (26.26) Mr. Winberg confirmed this, adding that the Secretariat relies on internal audit reports, which it analyses. (1640). However, the audit found that, with respect to the audited sample, the departments "have done some internal audit work on contracting practices, but generally not at a significant level." (26.26)

Throughout the better part of their testimony, Secretariat officials insisted that the sample size used for the audit was small when compared to the volume of government procurement. The Auditor General acknowledges in his Report that because a selected sample was used "the results cannot be generalized statistically." (26.20) In their initial testimony, the Secretariat witnesses appeared to take the view that since the sample size was not statistically relevant, all was well with the sole-sourcing process. The audit findings did not appear to cause them any significant concern. Yet the Secretariat has not been doing the kind of monitoring or analysis that would provide the evidence to justify confidence.

While the Committee agrees that the audit results cannot be generalized to departments as a whole, it believes that they are a clear signal that problems may extend beyond the boundaries of the sample. This is a possibility that warrants a more profound examination. Mr. Potts agreed, telling the Committee that he would "like it to be broadened to find out whether or not this is a more widespread issue." (1635) Mr. Potts, however, was asked at a later stage whether the Secretariat was going to conduct a full-scale review to find out the actual extent of the problem. He replied, "not at this stage, we have no plans to conduct any further reviews on a larger sample basis." He then confirmed again that the Secretariat was not interested in doing a large review. (1645)

From the Committee's perspective, many of the problems associated with sole-source contracts would be eliminated through adherence to existing policies. This applies to the Secretariat's fulfilment of its own responsibilities, which, if met, might have averted many of the problems reported in the audit. Accordingly, the Committee recommends:

That Treasury Board Secretariat begin immediately to adhere to Section 5.1 of its Contracting Policy by:

- a) Issuing a report on contracting on at least an annual basis, if not more frequently. Data contained in these reports must be audited;
- b) Requiring all departments and agencies awarding contracts and/or amendments to submit annual reports to the Treasury Board Secretariat on all contracting activities;
- c) Evaluating departmental compliance with contracting policies and level of competitive contracting; and
- d) Conducting periodic reviews of contracts for the services of individuals, including those for less than \$5,000. The results of these reviews must be included in Treasury Board Secretariat's Contracting Activity Report.

Furthermore, the Committee recommends:

That Treasury Board Secretariat proceed with timely implementation of its framework for evaluating contracting activities and that it make use of this framework to conduct a broader review of sole-source contracts along the lines followed by the Auditor General, the results of this review to be tabled in the House of Commons no later than 31 March 2000; and

That in developing its framework for evaluating contracting activities Treasury Board Secretariat make use of the directions provided by the Auditor General on how best to measure contracting performance as contained in Chapter 6 of his April 1997 Report to the House of Commons (Contracting Performance).

The Committee notes that in his Report the Auditor General observes that "departments disregard the rules that apply to sole-sourcing" and that disregarding the rules "appears to involve no significant consequences for either the managers or their departments." (26.7) One way of providing a meaningful consequence would be through the introduction of positive sanctions to encourage adherence to the rules. In his testimony, the Auditor General indicated that the government is heading in the direction of introducing more performance factors into the remuneration of public servants in the executive category. Mr. Potts confirmed this. (1630) Bearing this in mind, the Committee recommends:

That following development and implementation of its framework for evaluating contracting activities, Treasury Board Secretariat use contracting performance as one of the components to be used in any potential effort to assess the remuneration of senior public servants.

At several points in their testimony, Secretariat officials emphasized that individual departments bear the responsibility for implementing contracting regulations and policy. In recognition of this, the Committee recommends:

That Treasury Board Secretariat encourage departments to include specific references to their contracting activities in their annual Performance Reports beginning with those reports issued for the period ending 31 March 1999.

Earlier, the Committee noted that departments may issue Advance Contract Award Notices (ACANs) signalling their intention to sole-source a contract. In both his Report and his testimony the Auditor General argues that the issuance of an ACAN does not by itself justify sole sourcing nor does it constitute competitive tendering. In

contrast, Mr. Winberg told the Committee that “if the procurement is transparent, if industry is aware of the opportunity and if they have the opportunity to participate, we believe that the contract should be deemed to be competitive.” (1645) It was brought to Mr. Winberg’s attention that a sample ACAN had the words “this is not a competitive bid solicitation” printed on it. The same ACAN states that the Crown “reserves the right not to open this procurement to competition.” Mr. Winberg assured the Committee that the Secretariat would be ensuring that the statement “this is not a competitive bid solicitation” would be removed from ACANs in the future. (1645)

The Committee agrees with Mr. Winberg that the issuance of an ACAN makes the contracting process more transparent. Departments, however, are not required to issue ACANs when they intend to sole-source a contract and, in the audited cases, “few of the contracts had been advertised using an ACAN.” (26.35) The Committee therefore recommends:

That the Government Contract Regulations and the Treasury Board Secretariat’s Contracting Policy be amended to make the issuing of ACANs obligatory in those instances in which departments intend to sole-source contracts valued over \$25,000 on the basis of an initial determination that only one person or firm is capable of providing the service;

That Treasury Board Secretariat instruct all departments to remove immediately the words “this is not a competitive bid solicitation,” and any references to the effect that the Crown is reserving the right not to open the procurement to competition, from all Advance Contract Award Notices; and

That the Government Contract Regulations and the Treasury Board Secretariat’s Contracting Policy be clarified by clearly stipulating that the issuance of an Advance Contract Award Notice does not constitute a fifth exception making the letting of a sole-source contract permissible, and that all departments be advised of this fact forthwith.

Conclusion

The rules governing the government’s contracting practices are intended to support two complementary principles: best value and open access. The rules recognize that open competition is the best way to satisfy these principles. They also recognize that forgoing competition in favour of sole sourcing should only occur under tightly defined circumstances.

Although the views of the Committee’s witnesses diverged on several key issues, they were all in agreement that these rules are sound. The Committee adds its endorsement to theirs. A combination of adherence to the rules, improved scrutiny, assessment and reporting by Treasury Board Secretariat, and the adoption of measures recommended by the Auditor General of Canada and this Committee should result in contracting practices that all recognize as desirable.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 55 and 61*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 2 June 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWENTY-NINTH REPORT

The Standing Committee on Public Accounts has considered Chapter 2 of the April 1999 Report of the Auditor General of Canada (*Revenue Canada – Underground Economy Initiative*) and the Committee has agreed to report the following:

Introduction

As reported by the Office of the Auditor General, reliable estimates indicate that the underground economy results in tax evasion and represents an estimated loss of federal and provincial tax revenues of up to \$12 billion each year.

Tax evasion is not a victimless crime. It puts honest businesses at a competitive disadvantage and, in some cases, out of business. It also causes honest taxpayers to bear the tax load of those who cheat. The integrity of the tax system is based on the public belief that Revenue Canada operates with the basic expectation that everyone must and does pay his or her fair share of taxes due under the law.

Revenue Canada has always had compliance programs to combat tax evasion. For example, the Department's special investigations and non-filers program for both GST and income tax and for various other enforcement programs. However, in the early 1990s there was a general perception that the underground economy was a growing problem.

To deal with this problem and to preserve the integrity of the tax system, Revenue Canada announced a new initiative in 1993 to combat the underground economy by allocating 200 staff to its non-filers and non-registrant program and 1,000 staff to the audit of small businesses.

The initiative was intended to increase the chances that unreported income would be detected, to enforce the payment of taxes from unreported income, to develop new activities to support taxpayers in meeting their responsibilities and to deter taxpayers from participating in the underground economy.

The Auditor General focussed on the results of the implementation of the Underground Economy Initiative.

It was with these issues in mind that the Standing Committee on Public Accounts decided to consider the findings of chapter 2 of the April 1999 Report of the Auditor General of Canada on Revenue Canada – Revenue Canada: The Underground Economy Initiative. The Committee met on the 11 May 1999 with Mr. Shahid Minto (Assistant Auditor General) and Mr. Barry Elkin (Principal, Audit Operations Branch). Representing Revenue Canada were Mr. Barry Lacombe (Assistant Deputy Minister, Verification, Enforcement and Compliance Research Branch), Mr. John Kowalski (Director General, Audit Directorate) and Ms. Dominique Short (Director General, Compliance Research Directorate).

Observations and Recommendations

In his opening remarks, the Assistant Auditor General, Mr. Shahid Minto, stated that as it was planned, the Underground Economy Initiative was a balanced approach to combating tax evasion and the underground economy, combining enforcement activities and initiatives designed to encourage voluntary compliance.

After five years into the implementation of the initiative, the Auditor General made the following observations; 1) Revenue Canada did recover additional taxes and, to a degree, 2) has sent a message to tax evaders that the department is determined to deal with the problem.

The Auditor General expected Revenue Canada to measure and report the tax impact and other results of the Underground Economy Initiative. However, the Auditor General noted that Revenue Canada does not fully report all Underground Economy Initiatives and their long-term effects on tax compliance.

Revenue Canada reports a \$2.5 billion tax impact but as the Auditor General observes the amount includes results of regular, ongoing enforcement programs. The Auditor General estimates the Underground Economy Initiative tax impact at \$ 500 million of tax reassessments over the last five years. The Auditor General realizes that the amounts of tax collected will be less than the amounts assessed.

The Auditor General also believes that Revenue Canada needs to adjust its tax assessment strategy. Instead of focussing on four sectors, it should reallocate its resources and efforts to identify taxpayers with the highest risk of unreported income in all sectors. Finally, the Auditor General noted that there had been a recent decline in the frequency of the department's community visits. Most of the Initiative's activities had focussed on tax audits and other enforcement efforts at the expense of facilitation and education activities to combat the underground economy.

The Auditor General recommends that the department collaborate with others to get more external sources of information to detect tax evaders and to improve its techniques with audit targeting and file selection. The audit team also signals that additional legislative opportunities exist to deter tax cheats. (1540)

Revenue Canada's Assistant Deputy Minister, Mr. Barry Lacombe, stated in his opening remarks that the Department appreciates the efforts the Auditor General had made in pointing out a number of areas for improvement, and that the Department agrees with his recommendations. Mr. Lacombe went on further to ensure the committee that the new Customs and Revenue agency would continue to honour its commitments to implement the recommendations of the Auditor General with respect with the Underground Economy Initiative. The agency would remain accountable to Parliament for its activities and its performance through the submission of annual reports. The witness concluded that the department is confident that the action plan already implemented along with ongoing work and other planned activities will further enhance Revenue Canada's continuing efforts to combat the underground economy. (1550)

In his opening statements, Mr. Lacombe indicated that Revenue Canada's enforcement activities resulted in an overall tax compliance rate of 98 percent. (1545) When the Committee inquired further on this, Mr. Shahid Minto informed the Committee that the 98 percent compliance rate referred only to the number of tax returns filed, not the actual amount of taxes assessed or collected. (1625)

The issue that concerned many committee members was the observed imbalance between enforcement efforts and facilitation activities in the Underground Economy Initiative, most notably in the decline in community visits.

When questioned about this, Mr. Lacombe, shared the Committee's concerns on this issue. He acknowledged the importance and effectiveness of these community visits, that they performed an outreach and educational function in assisting taxpayers in recognizing and respecting their tax responsibilities. He went on further to state that the Department was itself unhappy at the decline in the frequency of community visits and is planning measures this year to rectify the imbalance between enforcement efforts and social marketing activities. (1555)

This prompts the Committee to recommend the following:

That Revenue Canada continue its current and planned measures to redress the balance between its tax enforcement efforts and its education and facilitative activities of the Underground Economy Initiative.

That Revenue Canada report the results of these measures in its annual Performance Report to Parliament, starting 31 October 1999.

Another area of concern was the discrepancy between the Department's measurement of the tax impact of the Underground Economy Initiative and that of the Auditor General of Canada. According to Revenue Canada, the tax impact of the Initiative was \$ 2.5 billion, while the Auditor General estimated a tax impact of \$ 500 million for the same Initiative.

The Assistant Deputy Minister, Mr. Lacombe, did not disagree with the Auditor General's evaluation of the Initiative's tax impact. According to the witness, the discrepancy mainly resulted from difficulties in precisely attributing the tax impact to specific departmental initiatives. These difficulties arise because underground economy audits are very time consuming, employ indirect methods of verification, and reporting systems upgrades must compete with other continuing upgrade projects such as the Y2K and other changes to reporting systems. (1605)

When questioned whether the Department had systems in place to precisely measure and report the tax impact, Mr. Lacombe stated that Revenue Canada was presently upgrading its reporting systems. The Committee secured a commitment from the witness to report back when proper reporting systems are to be installed along with their implementation timetables. (1610) Mr. Lacombe indicated that the required information could be ready within a few weeks. He also volunteered to share with the Committee the planned performance indicators and those already in place. The Public Accounts Committee secured a commitment from the witness to present a report by the end of May 1999. (1610)

The Committee proposes the following recommendations:

That Revenue Canada should record and report the additional gross income identified by its Underground Economy Initiative and non-Initiative enforcement activities, the additional tax due on this unreported income, and how much the reassessed additional taxes the Department actually collects.

That Revenue Canada provide to the House of Commons Standing Committee on Public Accounts with a preliminary report on the progress of these increases in assessments and collections along with a description of planned and actual performance indicators currently in place by 31 May 1999.

That Revenue Canada inform Parliament of the continuing progress of this Initiative through its annual Performance Report to Parliament, starting 31 October 1999.

Some committee members inquired about the merits of tax amnesties as a means of further encouraging disclosure of unreported income and ensuring compliance with tax laws. Mr. Lacombe indicated that there were serious shortcomings associated with such an approach. The witness stated that studies on tax amnesties suggested that they may increase tax collections in the short run, but in the long run tax revenues decline as a result of taxpayer compliance problems. (1635)

To support Mr. Lacombe testimony, the Assistant Auditor General, Mr. Shahid Minto, quoted the first conclusion from a report prepared by the Joint committee on Taxation of the United States Congress:

The Staff of the Joint Committee on Taxation estimates that the federal tax amnesty program would result in a net revenue loss for the federal government. This net revenue loss occurs primarily because the federal tax amnesty is estimated to have long-run effects of reducing overall taxpayer compliance with federal laws. (1640)

In lieu of considering tax amnesties, Mr. Lacombe indicated that there was already an established voluntary disclosure program which is designed to encourage and foster voluntary compliance of Canadian tax laws. Under the

program, if a taxpayer has given incomplete information in a return and subsequently submits voluntarily the missing information, the taxpayer will not be required to pay the penalty, but only the tax owing on the adjusted income, with interest.

The Committee thus recommends the following:

That Revenue Canada develop initiatives to improve the promotion and enhance the public profile of its Voluntary Disclosure Program as a means of further encouraging disclosure of unreported income and ensuring compliance to Canadian tax laws.

That Revenue Canada provide information on the progress of these initiatives in its annual Performance Report to Parliament, starting 31 October 1999.

Concerns were raised about immigration trusts. According to paragraph 22 of the Auditor General of Canada Special Report – *Examination of the Requirement to Report Specified Foreign Property Under Section 233.3 of the Income Tax Act*:

This is a non-resident trust that an individual can set up before immigrating to Canada. Any or all of the individual's offshore assets can be placed in the trust. As long as the assets are left in the trust and are not brought into Canada, income generated from them will not be taxed in Canada for a period of five years. After that, the regular rules will apply and the investment income on those assets to those who remain in Canada will be taxed. This effectively gives a new Canadian relief from taxes for five years on all income from investment left offshore in the trust.

Mr. Shahid Minto indicated that given that it is now possible to apply for Canadian citizenship and passport after three years as a Canadian resident, the opportunity exists for individuals to set up an immigration trust, come to Canada for three years and apply for a passport. Once a passport has been issued the individual can then become a non-resident without paying any Canadian taxes on world-wide income. (1655)

The committee inquired about what actions Revenue Canada intended to undertake to deal with this loophole. Mr. Lacombe replied that the Department was currently exchanging information with Citizenship and Immigration to deal with this particular issue. He also proposed to communicate the Committee's interest in the matter to the Department of Finance because, according to Mr. Lacombe, this is a tax policy issue.

When the Committee inquired about the penalties regarding the failure to report foreign income, the Assistant Deputy Minister, Mr. Lacombe indicated that in terms of foreign income verification, the penalty for not accurately reporting was equivalent to five percent of the value of unreported assets.

Mr. Shahid Minto, commented that the statement was substantially accurate but added there was uncertainty as to whether the penalties would be actually enforced considering a ministerial announcement indicating the enforcement of rules would be waived for the first two years.

Mr. Lacombe replied that this practice was not unusual. Penalties would be applied in cases of blatant non-compliance, but the Department preferred to provide assistance to people in order to ensure the proper reporting of foreign income. Mr. Shahid Minto reiterated the Auditor General's position that the act is in place and that it is unusual for the tax administration to deliberately not enforce its own tax laws. (1700)

After listening to the testimony, the Committee is concerned that this practice may send a mixed message to taxpayers about Revenue Canada intention to enforce tax laws. In light of this, the Committee urges:

That Revenue Canada review and clarify its position concerning the application of penalties on undeclared foreign income and ensure the equitable and consistent enforcement of these tax laws.

Conclusion

The Standing Committee on Public Accounts acknowledges the Department's current and planned initiatives regarding the underground economy. However, it is concerned about the Department's ability to properly measure and record the tax impact directly attributable to the Underground Economy Initiative. Also of concern, was the current emphasis on enforcement efforts at the expense of education and facilitation activities, and the Department's application of the provisions of the Income Tax Act regarding the reporting of foreign income. The Committee urges Revenue Canada to follow through with proper corrective measures to address all the shortcomings identified in the Auditor General's report.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meeting No. 62*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORT TO THE HOUSE

Wednesday, 2 June 1999

Pursuant to Standing order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

THIRTIETH REPORT

The Standing Committee on Public Accounts has considered Chapter 4 of the April 1999 Report of the Auditor General of Canada (*Fisheries and Oceans — Managing Atlantic shellfish in a Sustainable Manner*) and the Committee has agreed to report the following:

Introduction

The shellfish fishery is a major component of Atlantic Canada's fisheries. In 1997, for example, the landed value of all shellfish in Atlantic Canada was \$920 million, or 81% of the value of all fish landed in the region. The ongoing health and economic viability of this resource is of particular importance in light of the collapse of the region's groundfish stocks in the early 1990s.

Due to the importance of the shellfish fishery and the need to manage this resource wisely, the Committee decided to review the results of the Auditor General's audit of Fisheries and Oceans Canada's management of the lobster, scallop, snow crab and shrimp fisheries in Atlantic Canada. Accordingly, the Committee met on 13 May 1999 with Mr. Denis Desautels, FCA, Auditor General of Canada, and Mr. John O'Brien, Principal, Audit Operations Branch of the Office of the Auditor General. Mr. Larry Murray, Associate Deputy Minister, Mr. Jacques Robichaud, Director General, Resource Management Directorate, and Mr. Howard Powles, acting Director, Fisheries Research Branch, represented Fisheries and Oceans Canada (the Department).

Observations and Recommendations

Mr. Desautels summarized the results of the audit in his opening remarks. He began by outlining the similarities between the findings of this audit and those of an audit of the Department's management of the Atlantic groundfish fishery that was reported in October 1997. In both instances problems stemmed from similar causes. The Auditor General pointed to the need to clarify fisheries legislation, create a national fisheries policy, establish measurable indicators and performance expectations, improve fisheries management planning, improve catch monitoring and enforcement, and deal with the problem of overcapacity in an effective manner in order to properly manage the shellfish fishery. He then outlined some of the problems surrounding the management of the Atlantic shellfish resource in the absence of fulfillment of these requirements. (1535, 1540)

Mr. Murray responded on behalf of the Department. Rather than addressing the audit observations and recommendations directly, however, he chose to emphasize the way in which the Department is changing its approach to fisheries management in general. His remarks can be summed up easily: resource conservation is the Department's overriding objective, one that all departmental decisions and activities must support. He stated, toward the end of his comments, that the Department has either agreed to take action on the Auditor General's recommendations, or already has initiatives underway to do so. (1540, 1545)

The Committee is pleased to see that the Department is responding positively to the audit. Nevertheless, the Committee has a number of concerns that it believes that the Department must address with concrete actions taken on an urgent basis.

Principal among the Committee's concerns is the absence of a sustainable fisheries framework that would establish clear objectives for fisheries management and serve to guide decision making over the long term. In the absence of such a framework, the logic and the rules supporting decisions are unclear to both departmental managers and industry stakeholders. It is also unclear to Parliament, industry stakeholders, and Canadian taxpayers what the Department is trying to achieve through its management of the fisheries.

Confusion over what the Department is trying to achieve through its management of the shellfish fishery underscores the need for a sustainable fisheries framework. The Department states that its goal is "conservation", yet as the Auditor General points out, it has not specified what it means by this term nor does it, in most instances, have ways of determining whether this goal has been achieved. (4.46, 4.47) Furthermore, decisions taken by the Department have economic and social implications, a factor acknowledged by Mr. Murray. (1605, 1650) It is not clear, however, whether the Department is willing to accept responsibility for outcomes in these areas, even though the audit found examples of decisions in the shellfish fisheries directed towards the achievement of economic and social outcomes. (4.23–4.27, Exhibit 4.3). In response to a question from the Committee, Mr. Murray testified that:

It is difficult in the context of a department [of] our size to know exactly what we've said when, which confirms the need for us to be clearer and to have a policy framework so it is clearer to everyone that when we're talking about outcomes ... that we're not running HRDC [Human Resources Development Canada]. We are running an organization that is there to manage the fish and to ensure that the industry remains viable in the future for as many human beings as possible. Obviously the decisions the Minister takes every day have a social impact, but the driving factor ... is to ensure that there's a viable fishery and a way of life for those people who are in the industry. (1610)

The lack of a clear policy framework may also explain some shortcomings in the accountability documents (annual Reports on Plans and Priorities and departmental Performance Reports) that are tabled in Parliament by Fisheries and Oceans Canada. For example, there are no references made to overall economic objectives when the Department discusses its expected results for fisheries management. In addition, although Mr. Murray testified that social factors are taken into account when the Department reaches conservation decisions, this is not reflected in reports to Parliament. (4.21–4.22) From the Committee's perspective, this hinders Parliament's ability to hold the Department accountable for the social and economic outcomes generated by its management of the fisheries.

Mr. Murray signaled the Department's agreement that a better policy framework is required. He informed the Committee that the Department has recently established a Working Group to reform Atlantic Fisheries Policy and to clarify its management policies. Mr. Murray stated that the Working Group's mandate is to create a cohesive and consistent policy framework to allow the establishment of biological reference points and more comprehensive rules for taking conservation-related decisions. (1545) He also agreed to provide the Committee with a copy of the Group's mandate and structure. (1620)

These are welcome initiatives. The Committee observes, however, that in 1997 the Department made a commitment to establish a consolidated policy framework related to sustaining the fisheries resource base in response to recommendations made by the Auditor General. Yet two years later, the Auditor General informed this Committee that the Department "has not yet developed a fisheries management framework that considers all aspects of sustainability." (1535) Furthermore, although Mr. Murray agreed that it is "quite urgent" for the Working Group to finish its work (1620), he did not provide a target date for completion of a policy framework.

The Committee agrees with the observation made by the Auditor General that "part of the reason for the continuing problems ... rests with the existing framework for fisheries management," (1535) and accordingly recommends:

That Fisheries and Oceans Canada establish target deadlines for the completion and implementation of a cohesive and consistent sustainable fisheries management framework. These deadlines must take full account of the urgent need for this framework.

Furthermore, the Committee recommends:

That Fisheries and Oceans Canada ensure that the framework:

- Clearly defines measurable conservation objectives, specifying the indicators that will be used to assess their achievement;
- Establishes expected results for economic objectives;
- Recognizes that social factors play a key role in ensuring the long-term sustainability of the fisheries; and
- Provides guidance on how the Department is to achieve an appropriate balance between biological, economic, and social factors when it makes fisheries management decisions.

The Committee was interested to note that to a growing extent the Department is engaging in co-management practices with industry stakeholders. In principle, the Committee supports this approach which enables a sharing of decision-making power, responsibility, and risk between the Department and stakeholders. The Committee believes that this approach should also apply to the development of the policy framework and therefore recommends:

That Fisheries and Oceans Canada consult with industry stakeholders on a regular basis in the process of developing a sustainable fisheries framework.

Since elements of this framework may require legislative change and indeed be strengthened by it, the Committee recommends:

That the Department give careful consideration to giving the appropriate legislative recognition to the principles that the framework is meant to implement.

Because it is vital that Parliament be able to hold the Department to account for the outcomes that result from its fisheries management decisions, the Committee also recommends:

That Fisheries and Oceans Canada revise its annual Report on Plans and Priorities and its departmental Performance Reports to reflect the biological, economic and social expectations and outcomes of its fisheries management decisions and activities. The Committee expects that these revisions will be in place by the end of fiscal year 2000–2001.

In his Report and testimony before the Committee, the Auditor General raised the problem of harvesting capacity in the Atlantic shellfish industry. While the Department has been taking steps to reduce capacity in the groundfish sector (4.34), it has put in place incentives to increase capacity in the shellfish industry (4.35). The Auditor General warns that the new and enlarged vessels that have resulted “have a large potential harvesting capacity, which could readily be redirected to harvest groundfish” thus offsetting previous reduction efforts in that area. (4.36) The Committee believes that more needs to be known about capacity and therefore recommends:

That Fisheries and Oceans Canada conduct a thorough study of the harvesting capacity in the Atlantic fisheries, placing an emphasis on clarifying what the Department means by capacity and on determining trends in this area. The Committee expects that the results of this study will be reported to it by 30 September 1999 and that the subject of capacity will be addressed in the Department's subsequent Performance Reports, beginning with the report for the period ending 31 March 2000.

One of the leading concerns expressed by Committee Members involved the scientific capacity required by the Department in order to make sound resource management decisions. In his Report, the Auditor General provided examples of weaknesses in the information available to support resource use decisions; some of these weaknesses involved the quality of scientific information. (4.52)

Mr. Murray informed the Committee that the Department will be spending \$6.5 million over the next year to hire 82 new scientists (1625), despite a Committee Member's concern about announced budgetary reductions in this area of the Department's operations. Mr. Murray also stated that the Department is involved in a government-wide science and technology initiative. (1710)

For his part, the Auditor General testified that although he was not able to provide a definitive conclusion about the Department's scientific capacity, he was left with the impression that "the resources on that side have been reduced substantially, and therefore the Department might have lost some capacity." (1555)

The Committee firmly believes that the Department must have sufficient scientific information in order to manage the resource in a sound, cost-effective manner. It therefore recommends:

That Fisheries and Oceans Canada arrange to have an independent, objective assessment conducted of its scientific capacity and table this study along with its conclusions and recommendations in Parliament no later than 31 March 2000. Within three months, the Department should subsequently table an action plan addressing the study's recommendations.

The Committee takes note of the Auditor General's concerns regarding the Department's monitoring, control and surveillance activities, or MCS. The audit found that there was a lack of co-ordination in planning MCS (4.66), and that there were other problems with dockside monitoring (4.69), at-sea observers (4.72–4.77), aerial surveillance (4.80), and enforcement. (4.80–4.84). Although Mr. Murray indicated the Department's agreement with all of the audit recommendations, there were none that were specific to MCS. The Committee believes that this aspect of the Department's work is essential to a well-managed fishery and therefore recommends:

That Fisheries and Oceans Canada table an action plan with the House of Commons Standing Committee on Public Accounts detailing how it will resolve problems identified by the Auditor General of Canada in its monitoring, control surveillance, and enforcement activities. This action plan should be submitted to the Committee no later than 30 September 1999.

The Committee is deeply concerned about certain arrangements between the Department and third parties, as reported in paragraphs 4.101 to 4.104 of the Auditor General's Report. In one instance, a fee for access totaling \$5 million in 1997, and \$2 million in 1998, was imposed by the Department in a manner, according to the Auditor General, that may not have been contemplated in legislation. (4.101) In the other instance, the Auditor General reports that the Department was using a specified purpose account to reimburse its own departmental expenditures without proper authority and in a manner that does not conform to Treasury Board policy. (4.103, 4.104) These concerns were elaborated on in testimony given before the Committee. (1615, 1625)

Mr. Murray testified that the Department had looked into the concerns raised by the Auditor General. Although Fisheries and Oceans concluded that its actions were "legitimate and appropriate," Mr. Murray testified that the Department believes that the Auditor General's concerns were correct and that adjustments have been made as a consequence. (1615)

The Committee considers these matters to be quite serious and requires absolute assurance from the Department that it will conduct further activities of this sort in conformity with existing legislation and Treasury Board policies. The Committee fully appreciates the Department's efforts to make adjustments in response to the Auditor General's concerns and recommends:

That Fisheries and Oceans Canada table a report with the House of Commons Standing Committee on Public Accounts outlining the measures it has implemented to ensure that its use of specified purpose accounts and financial arrangements with third parties adhere faithfully to legislative and policy requirements. This report should be presented to the Committee no later than 30 September 1999.

Conclusion

Proper management of fisheries resources must be based on a framework that produces consistent, logical decisions. Such a framework must clearly define and balance the goals that are to be achieved and set forth the rules that are to be followed. In the absence of an appropriate framework, the kind of inconsistent, ad hoc decision making uncovered by the audit is bound to occur. Indeed, it is almost inconceivable that a resource that is of such importance to the economy and people of Atlantic Canada and the country as a whole would be managed without such a framework.

Two years ago, in response to a series of audits conducted by the Auditor General centered on the management of Atlantic Canada's groundfish fisheries, Fisheries and Oceans Canada made a commitment to establish a sustainable fisheries framework. Now, a subsequent audit of the Department's management of Atlantic shellfish stocks has revealed problems that parallel those in its conduct of the groundfish industry — problems that might have been minimized or eliminated had a sustainable fisheries framework been in place. While there are no indications of an imminent collapse of the shellfish fishery (as happened with groundfish stocks), there are no guarantees of sustainability without careful co-ordination and planning.

It is therefore imperative that Fisheries and Oceans Canada assign urgent priority to the creation and implementation of a sustainable fisheries framework in order to ensure the long-term viability of the shellfish, and other, fisheries. A sincere and determined effort to implement the Auditor General's recommendations along with those suggested by this Committee will help the Department succeed in this effort.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meeting No. 63*) is tabled.

Respectfully submitted,

John Williams

Chair

APPENDIX D

REPORT ON THE AUDIT OF THE PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT:

TABLINGS IN PARLIAMENT FOR PARENT CROWN CORPORATIONS: ANNUAL REPORTS AND SUMMARIES OF CORPORATE PLANS AND BUDGETS

The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period, and the time they were actually tabled. The report on tablings is the responsibility of the President of the Treasury Board and is included in her annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December (not tabled for 1999 at time of going to press).

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 1999. Further, I am required to report on this audit in my annual Report to the House of Commons.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining, on a test basis, the systems and procedures used by the Treasury Board Secretariat to monitor the tabling of the summaries and annual reports in each House of Parliament, and the information contained in the report. Accordingly, it included such tests and other procedures as I considered necessary in the circumstances.

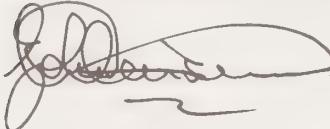
In my opinion, the information contained in the report on tablings is accurate in all significant respects in accordance with the description of the Deadlines for Tabling in Parliament disclosed in the report.

The following paragraphs are intended to highlight certain information that I believe may be of interest to members of the House of Commons and that are not highlighted or disclosed in the report on tablings in its current format.

This year's report on tablings identifies 72 instances of documents that were tabled late. Twenty-six of those instances relate to documents that were due to be tabled in prior years and accordingly were reported as late in prior years' reports on tablings. The remaining 46 instances represent approximately 16 percent of those documents that were required to be tabled in the year ending 31 July 1999; this is similar to previous years.

The report on tablings does not highlight the fact that only the first year (1998–99) of Atomic Energy of Canada Limited's (AECL) five year corporate plan for 1998–99 to 2002–03 was approved by the Governor in Council, nor does it disclose that AECL's previous three corporate plans were not approved, as contemplated by subsection 122(1) of the *Financial Administration Act*.

Finally, the report does not disclose that there were delays in Governor in Council approval of the 1998–99 to 2002–03 corporate plan and Treasury Board approval of the 1998–99 operating and capital budgets of the Enterprise Cape Breton Corporation. The corporate plan was approved well after the end of the first year it covered and the budgets well after the end of the 1998–99 fiscal year. As a result, the related summaries had not been tabled in either House of Parliament as of 31 July 1999.



John Wiersema, CA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada

22 October 1999

APPENDIX E

The Costs of Crown Corporation Audits Conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see Exhibit 1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1999, the full cost of the annual audit report was \$482,065.

Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 1998–99 the Office completed the special examination of eight Crown corporations. The costs were:

Atomic Energy of Canada Ltd.	\$ 875,779
Business Development Bank of Canada (Joint Examiner)	\$ 580,378
Canada Mortgage and Housing Corporation	\$ 956,176
Canadian Commercial Corporation	\$ 247,459
Defence Construction (1951) Limited	\$ 210,091
National Arts Centre Corporation	\$ 644,432
Pacific Pilotage Authority	\$ 101,729
Via Rail Canada Inc.	\$ 1,189,668

Exhibit 1**Costs of Preparing Annual Audit Reports for Fiscal Years Ending on or before 31 March 1999**

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.98	\$ 55,442
Atomic Energy of Canada Limited (Joint Auditor)	31.03.99	217,662
Atomic Energy Control Board	31.03.99	50,016
Business Development Bank of Canada (Joint Auditor)	31.03.99	202,744
Canada Deposit Insurance Corporation	31.03.99	119,353
Canada Development Investment Corporation (Joint Auditor)	31.12.98	44,003
Canada Lands Company Limited (Joint Auditor)	31.03.99	132,553
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.98	231,389
Canadian Commercial Corporation	31.03.99	80,760
Canadian Dairy Commission	31.07.98	129,350
Canadian Museum of Civilization	31.03.99	79,527
Canadian Museum of Nature	31.03.99	85,899
Cape Breton Development Corporation	31.03.99	310,202
Defence Construction (1951) Limited	31.03.99	47,748
Enterprise Cape Breton Corporation	31.03.99	119,135
Export Development Corporation	31.12.98	461,057
Farm Credit Corporation	31.03.99	358,947
Federal Bridges Corporation Ltd.	31.03.99	39,113
Freshwater Fish Marketing Corporation	30.04.98	142,689
Great Lakes Pilotage Authority, Ltd.	31.12.98	58,060
Laurentian Pilotage Authority	31.12.98	79,962
Marine Atlantic Inc.	31.12.98	228,709
National Capital Commission	31.03.99	198,051
National Gallery of Canada	31.03.99	94,872
National Museum of Science and Technology	31.03.99	69,244
Old Port of Montreal Corporation Inc.	31.03.99	112,533
Pacific Pilotage Authority	31.12.98	46,483
Petro-Canada Limited	31.12.98	13,883
Queens Quay West Land Corporation	31.03.99	54,251
Royal Canadian Mint	31.12.98	289,333
The St. Lawrence Seaway Authority	31.09.98	146,277
Seaway International Bridge Corporation Ltd.	31.12.98	41,782
The Jacques Cartier and Champlain Bridges Incorporated	31.03.99	78,202
Standards Council of Canada	31.03.99	49,695
VIA Rail Canada Inc. (Joint Auditor)	31.12.98	205,930

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